

# **FAQ on Financial Instruments and Exchange Act**

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# FAQ on Financial Instruments and Exchange Act

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# FAQ on Financial Instruments and Exchange Act

## Section 1 Purpose, etc.

Q1. What is the chapter structure of the Financial Instruments and Exchange Act (FIEA)?

A. The chapter structure of the FIEA is as follows.

Chapter number	Chapter title
Chapter I	General Provisions
Chapter II	Disclosure of Corporate Affairs and Other Related Matters
Chapter II-2	Disclosure Required for Tender Offer
Chapter II-3	Disclosure of Status of Large Volume Holding of Share Certificates, etc.
Chapter II-4	Special Provisions, etc. for Procedures by Use of Electronic Data Processing System for Disclosure
Chapter II-5	Provision or Publication of Specified Information on Securities, etc.
Chapter III	Financial Instruments Business Operators, etc.
Chapter III-2	Financial Instruments Intermediary Service Providers
Chapter III-3	Credit Rating Agencies
Chapter IV	Financial Instruments Firms Association (Authorized Financial Instruments Firms Association, Public Interest Corporation-Type Financial Instruments Firms Associations, Certified Investor Protection Organization)
Chapter IV-2	Investor Protection Fund
Chapter V	Financial Instruments Exchange
Chapter V-2	Foreign Financial Instruments Exchange
Chapter V-3	Financial Instruments Clearing Organization, etc.
Chapter V-4	Securities Finance Company
Chapter VI	Regulations on Transactions, etc. of Securities
Chapter VI-2	Administrative Monetary Penalty
Chapter VII	Miscellaneous Provisions
Chapter VIII	Penal Provisions
Chapter IX	Investigation into a Criminal Case, etc.
Supplementary Provisions	

Q2. What is the structure of the purpose provisions (Article 1) of the FIEA?
--

A. The structure of the purpose provisions of the FIEA is as follows (Article 1 of the FIEA).

(1) Measures for achieving the purposes

- Develop systems for disclosure of corporate affairs and other related matters
- Provide for necessary matters relating to persons who engage in Financial Instruments Business
- Secure appropriate operation of Financial Instruments Exchanges, etc.

(2) Direct purposes

- Ensure fairness in issuance of the Securities and transactions of Financial Instruments, etc.
- Facilitate the smooth distribution of Securities
- Aim at fair price formation of Financial Instruments, etc. through the full utilization of functions of the capital market

(3) Ultimate purposes

- Contribute to the sound development of the national economy
- Contribute to the protection of investors

## Section 2 Definitions

### Outline

Q1. What regulations are invoked where a Financial Instrument falls under the definition of “Securities” under the FIEA?
--

- A1. First, with regard to “Securities” regulations on conducting certain activities in the course of trade (regulations on conducting business) and those requiring or prohibiting the performance of certain activities by business operators (regulations on activities) are applied. Specifically, with regard to “Securities” the regulations on conducting business under the FIEA are applied to such activities as sales and purchases, etc., and, in principle, only persons registered as Financial Instruments Business Operators are permitted to conduct such activities in the course of trade (Article 29 of the FIEA). Financial Instruments Business Operators, etc. are subject to the regulations on activities under the FIEA, and in principle, they have obligations such as to deliver a document to the customer prior to the conclusion of a contract (Article 37-3; Chapter III, Section 2 of the FIEA).
2. Second, disclosure regulation under the FIEA is applied to “Securities” in principle. Specifically, as a disclosure rule in the primary market, with regard to Public Offering and Secondary Distribution of Securities, Issuers of Securities, etc. are obligated to facilitate public inspection of Securities Registration Statements by submitting them to the authorities and directly provide information to investors through the delivery of Prospectuses. As a disclosure rule in the secondary market, with regard to some types of Securities, such as listed Securities, Issuers of Securities, etc. are obligated to facilitate public inspection of Annual Securities Reports, etc. by submitting them to the authorities (Chapter II of the FIEA).
3. Third, with regard to “Securities” provisions that prohibit unfair transactions, including prohibition of wrongful acts (Article 157) and prohibition of spreading rumor, using fraudulent means, committing assault or intimidation (Article 158) are applied (Chapter VI of the FIEA).
4. Fourth, Financial Instruments Exchanges are permitted to handle “Securities” (Article 2(14) and (16), Chapter V of the FIEA).

Q2. What are beneficiary securities of beneficiary securities issuing trusts?
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- A1. "Beneficiary securities of beneficiary securities issuing trusts" (Article 2(1)(xiv) of the FIEA) are certificates indicating beneficial interests (beneficiary securities) of trusts for which issuance of beneficiary securities is provided for under the terms of trust (beneficiary securities issuing trusts). The definition is provided for in Article 185 of the Trust Act.
2. The Trust Act provides that Securities under private law may be issued with regard to beneficial interests by introducing the system of beneficiary securities issuing trusts (Chapter VIII of the Trust Act). Meanwhile, the FIEA prescribes beneficiary securities issuing trusts as Securities (Article 2(1)(xiv) of the FIEA).

Q3. What kinds of Financial Instruments are designated as “Securities” by Cabinet Order?
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- A1. The FIEA allows for additional designation of the Securities set forth in Article 2(1) and the "securities equivalents" set forth in Article 2(2) by Cabinet Order (Article 2(1)(xxi) and Article 2(2)(vii) of the FIEA).
2. Specifically, the Financial Instruments designated as the Securities set forth in Article 2(1) of the FIEA are deposit certificates of negotiable deposits issued by foreign judicial persons (Article 2(1)(xxi) of the FIEA; Article 1(i) of the Order for Enforcement of the FIEA (hereinafter referred to as the "FIEA Enforcement Order")), and Securities or certificates which indicate certain monetary claims (limited to those that are not nominative claims) against incorporated educational institutions, etc. and indicate matters including the name of the incorporated educational institution, etc. and the amount of the monetary claims (school bonds) (Article 1(i) of the FIEA Enforcement Order; Article 4 of the Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act (Definition Ordinance)). "Those that are not nominative claims" assumes monetary claims of which Securities or certificates do not indicate the creditors and are recognized to have the nature of Securities as bearer securities under private law (see Supreme Court judgment, June 24, 1969, Minshu Vol. 23, No. 7, p. 1143). They are not considered to include mere certificates of evidence.
3. In addition, the Financial Instruments designated as the "securities equivalents" set forth in Article 2(2) of the FIEA include claims pertaining to loans that are made to incorporated educational institutions, etc. and that satisfy all of the following requirements (Article 2(2)(vii) of the FIEA; Article 1-3-4 of the FIEA Enforcement Order; Article 8 of the Definition Ordinance):
- (1) loans with the same interest rate and due date that are made by multiple persons;
  - (2) loans made by persons other than interested persons (enrolled students, their parents, etc., graduates, and officers and employees of the incorporated educational institution) or loans of which claims are not prohibited from being transferred to persons other than interested persons; and
  - (3) loans made by persons other than banks, etc. or loans of which claims are not prohibited from being transferred to persons other than banks, etc. (including collection companies).

Q4. Why are deposits and insurance not designated as “Securities”?
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- A1. Since deposits and insurance are regulated under the Banking Act and the Insurance Business Act, they are not directly regulated under the FIEA by way of designating them as “Securities”
2. However, according to the basic idea to apply the same user protection rules (sales/solicitation rules) for Financial Instruments and transactions having the same economic nature, regulations equivalent to regulations on activities are secured for deposits and insurance with a strong investment character, by applying mutatis mutandis the regulations on activities under the FIEA pursuant to the Banking Act and the Insurance Business Act (Articles 13-4 and 52-45-2 of the Banking Act; Article 300-2 of the Insurance Business Act).

3. Meanwhile, Financial Instruments such as ordinary deposits, time deposits, and security-type insurance have a different economic nature from instruments with a strong investment character as represented by shares and corporate bonds. They do not involve any loss of principal caused by market risks and do not require application of regulations equivalent to regulations on activities for instruments with a strong investment character, so regulations on activities under the FIEA are not applied *mutatis mutandis* to these instruments. These deposits and insurance have also been subject to the regulations on activities<sup>(note)</sup> under the Banking Act and the Insurance Business Act .

(Note) Article 12-2 (Provision, etc. of Information to Depositors, etc.) and Article 13-3 (Prohibited Acts Pertaining to Business of Banks) of the Banking Act; Article 100-2 (Measures Concerning Business Operations) and Article 300 (Prohibited Acts Pertaining to Conclusion of Insurance Contract or Insurance Solicitation) of the Insurance Business Act

### **Interests in collective investment schemes (funds)**

Q5. What is the definition for interests in collective investment schemes under the FIEA?
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- A1. In recent years, due to progress in financial and IT technologies, the introduction of new "vehicles" through development of the legal system, and diversification of fund procurement and investment methods, new fund-type Financial Instruments which are not subject to existing user protection laws have emerged. In addition, there have been incidents of damage caused by business-type funds taking the form of Anonymous Partnerships targeting many general investors. Moreover, the Livedoor incident (violations of the Securities and Exchange Act by Livedoor) and other circumstances triggered active debates over investment partnerships and investment funds.
2. In response to such a situation, with a view to filling the regulatory "gaps" for ensuring application of user protection rules, the FIEA provides a comprehensive definition for rights that are categorized as "securities equivalents" (Article 2(2)(v) and (vi) of the FIEA). This comprehensive definition can be referred to as "interests in collective investment schemes (funds)." The FIEA provides for both rights based on domestic laws and regulations (Article 2(2)(v) of the FIEA) and rights based on foreign laws and regulations (Article 2(2)(vi) of the FIEA).
3. As rights based on domestic laws and regulations, the FIEA lists rights based on a partnership contract under the Civil Code, an Anonymous Partnership agreement under the Commercial Code, an investment limited partnership agreement, or a limited liability partnership agreement, as well as membership rights of an incorporated association (Article 2(2)(v) of the FIEA). These are only listed as examples of vehicles used for a collective investment scheme, and as clear from the phrase of "or other rights," the type of law is irrelevant in determining whether or not a right is categorized as an interest in a collective investment scheme.
4. The definition of an interest in a collective investment scheme consists of the following three elements (Article 2(2)(v) of the FIEA; Article 1-3 of the FIEA Enforcement Order):
- (1) the holder of the right (equity investor) invests or contributes money, etc.;

(2) a business is conducted by using the invested or contributed money, etc. ("Invested Business"); and

(3) the right enables the equity investor to receive dividends from profits arising from the Invested Business or distribution of the assets of the Invested Business.

However, because there may be rights that satisfy all of these requirements but do not necessarily need to be regulated under the FIEA, the FIEA excludes certain rights from the definition of interests in a collective investment scheme (Article 2(2)(v)(a) through (d) of the FIEA).

5. The term "collective" investment scheme may give an impression that it only includes schemes in which multiple persons make investments or contributions, but investments or contributions by multiple persons is not a requirement for a collective investment scheme under law. Therefore, a scheme in which a single person makes an investment or contribution can also fall under the comprehensive definition of a collective investment scheme.

<b>Q6. What regulations have been prescribed with regard to interests in collective investment schemes?</b>
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A1. To fill regulatory "gaps," the FIEA provides a comprehensive definition regarding interests in collective investment schemes (Article 2(2)(v) and (vi) of the FIEA) and treats the schemes as Securities. As a result, various regulations under the FIEA are applied to collective investment schemes.

2. First, disclosure regulation is applied to Public Offering or Secondary Distribution of interests in so-called investment-type collective investment schemes ("Rights in Securities Investment Business, etc.") (Article 3(iii), Article 4(1), Article 24(1), etc.).

3. Second, under regulations on conducting business, the following activities have been added to the scope of Financial Instruments Business.

(1) Self-offering of interests in collective investment schemes (solicitation by the Issuer itself of an application for the acquisition of such interests, including both through Public Offering and Private Placement) (Article 2(8)(vii)(f)). This activity falls under the definition of Type II Financial Instruments Business (Article 28(2)(i)).

(2) Management of investment (self-management) mainly in Securities or Derivative Transactions in the form of a collective investment scheme (Article 2(8)(xv)(c)). This activity falls under the definition of Investment Management Business (Article 28(4)(iii)).

Therefore, in order to conduct the above activities in the course of trade or as a business, not to mention the business of dealing in Public Offering or Secondary Distribution or dealing in Private Placement of interests in collective investment schemes (Article 2(8)(ix)), it is necessary to obtain registration as Financial Instruments Business Operators or Registered Financial Institutions, in principle (Articles 29 and 33-2).

4. Third, various regulations on activities are applied to Financial Instruments Business Operators, etc. which conduct these activities (Articles 34 through 45).

5. However, with regard to regulations on conducting business related to collective investment schemes, care is taken to avoid excessive regulation that could impede financial innovation based on the premise of protecting investors, thereby ensuring regulatory flexibility. To be more specific, business operations related to self-offering (Private Placement) of interests in collective investment schemes and Investment Management Business (self-management) involving such interests, if conducted only with professional investors (such as Qualified Institutional Investors, etc.) as counterparties, are regarded as "Specially Permitted Businesses for Qualified Institutional Investors, etc." and therefore they are exempted from the obligation for registration. Meanwhile, with regard to these businesses, notification is required in order to grasp the actual circumstances of business, and a simple set of regulations on activities, etc. is applied (Articles 63 through 63-4).
6. Fourth, regulations concerning various unfair transactions (Chapter VI) are applied to transactions involving interests in collective investment schemes as well. Under the FIEA, when Partnerships, etc. own 10% or more of the voting rights of Listed Companies, etc. as property of the Partnerships, etc., they are subject to the obligation for the submission of trading reports and for the provision of profits arising from sales and purchases conducted in the short term (Article 165-2).

<p>Q7. What kinds of rights are excluded from interests in collective investment schemes?</p>
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- A1. While providing a comprehensive definition regarding interests in collective investment schemes, the FIEA excludes categories of rights that are considered to have little need to achieve investor protection by regulating them under the FIEA from said definition under law, thereby clarifying the scope of application of the FIEA (Article 2(2)(v) of the FIEA).
2. Specifically, the following rights are excluded from application of the FIEA (Article 2(2)(v)(a) through (d)):
  - (1) rights where all of the equity investors participate in the Invested Business and where there is little need to protect the equity investors as investors;
  - (2) rights where the equity investors will not receive dividend of profits or distribution of the assets of the Invested Business in an amount exceeding the amount invested or contributed by them and where no investment nature is found;
  - (3) rights where the equity investors are protected under other Acts (Insurance Business Act, the Agricultural Cooperatives Act, the Small and Medium-Sized Enterprise Cooperatives Act, the Real Estate Specified Joint Enterprise Act, etc.) that apply mutatis mutandis the regulations on activities under the FIEA;
  - (4) rights that are found not to hinder the public interest or protection of equity investors because the necessary regulatory or supervising system is provided for under another Act or for other reasons.
3. Rights indicated on the Securities listed in the items of Article 2(1) of the FIEA and rights that are deemed as Securities pursuant to Article 2(2) of the FIEA (excluding interests in collective investment schemes) are excluded from the definition of interests in collective investment schemes

(Article 2(2)(v)). Accordingly, rights that are individually listed in Article 2(1) and (2), such as shares and membership rights of an incorporated association, are not categorized as interests in collective investment schemes.

**Q8. What are the cases where all of the equity investors participate in the Invested Business, which are excluded from the definition of interests in collective investment schemes?**

- A. "Cases where all of the equity investors participate in the Invested Business" (Article 2(2)(v)(a) of the FIEA), which are excluded from the definition of interests in collective investment schemes, need to satisfy all of the following requirements (Article 1-3-2 of the FIEA Enforcement Order):
- (1) the business execution of the Invested Business is conducted with the consent of all of the equity investors (including the case where there is an agreement on not requiring the consent of all of the equity investors but business execution is conducted after all of the equity investors manifest their intentions on whether or not to give consent on the decision of the business execution); and
  - (2) all of the equity investors satisfy either of the following requirements:
    - (i) to be regularly engaged in the Invested Business; or
    - (ii) to be engaged in the Invested Business while demonstrating a particularly specialized ability that is indispensable for the continuance of the Invested Business.

**Q9. What other rights are excluded from the definition of interests in collective investment schemes?**

- A1. The FIEA specifies the following rights as rights that are "found not to hinder the public interest or protection of equity investors" to be excluded from the definition of interests in collective investment schemes (Article 2(2)(v)(d) of the FIEA):
- (1) rights based on insurance or mutual aid contracts (those that are not subject to the Insurance Business Act) (Article 1-3-3(i) of the FIEA Enforcement Order);
  - (2) rights pertaining to investments in or contributions to juridical persons (excluding general incorporated associations other than public interest incorporated associations and general incorporated foundations other than public interest incorporated foundations) (Article 1-3-3(ii) of the FIEA Enforcement Order);
  - (3) rights based on shared forest contracts (Article 1-3-3(iii) of the FIEA Enforcement Order);
  - (4) rights based on partnership contracts, etc. where the Invested Business is the business of an attorney-at-law, certified public accountant, certified public tax accountant, etc. (Article 1-3-3(iv) of the FIEA Enforcement Order); and
  - (5) rights pertaining to an employee shareholding association, expanded employee shareholding association, or client shareholding association (Article 1-3-3(v) and (vi) of the FIEA Enforcement Order; Articles 6 and 7 of the Definition Ordinance).
2. Rights based on insurance or mutual aid contracts (those that are not subject to the Insurance Business Act) ((1) above) are excluded from the definition of interests in collective investment

schemes, given that rights subject to the Insurance Business Act are excluded (Article 2(2)(v)(c) of the FIEA).

3. Rights pertaining to investments in or contributions to juridical persons (excluding general incorporated associations other than public interest incorporated associations and general incorporated foundations other than public interest incorporated foundations) ((2) above) are excluded from the definition of interests in collective investment schemes, because given that provisions on supervision by administrative organs are stipulated under laws and regulations for juridical persons, there is no need to make them subject to regulations under the FIEA in an overlapped manner.

However, since there are no provisions on supervision by administrative organs for general incorporated associations other than public interest incorporated associations and general incorporated foundations other than public interest incorporated foundations, rights pertaining to investments in or contributions to such associations or foundations are not excluded from the definition of interests in collective investment schemes. Nevertheless, there are cases where, upon contribution of funds to a general incorporated association other than a public interest incorporated association or a general incorporated foundation other than a public interest incorporated foundation, an arrangement is made by articles of incorporation, etc. so that residual assets in an amount exceeding the amount of the fund contributed will not be distributed to the fund contributor and such arrangement is actually observed, and as a result of this, rights pertaining to such contribution fall under Article 2(v)(b) of the FIEA and are excluded from interests in collective investment schemes.

4. Rights based on shared forest contracts ((3) above) are excluded from the definition of interests in collective investment schemes, because provisions on supervision by prefectural governors are stipulated under the Act on Special Measures concerning Shared Forest.
5. Rights based on partnership contracts, etc. where the Invested Business is solely the business of an attorney-at-law, certified public accountant, certified public tax accountant, etc. ((4) above) are excluded from the definition of interests in collective investment schemes, because laws and regulations obligate certified public accountants, attorneys-at-law, certified public tax accountants, etc. to observe the articles of association of the organization to which they must become a member (institute of certified public accountants, bar association, certified public tax accountants' association, etc.) and are under the supervision of said organization.
6. Rights pertaining to an employee shareholding association or expanded employee shareholding association ((5) above) are excluded from the definition of interests in collective investment schemes, as was the case under the former Securities and Exchange Act and relevant regulations, because an employee shareholding association or expanded employee shareholding association purchases share certificates based on a specific plan instead of individual Investment Decisions and the business executor has little discretionary power on the matter, and because there is a social condition that such association contributes to the welfare of employees, etc. Rights pertaining to a

client shareholding association ((5) above) are also excluded from the definition of interests in collective investment schemes under certain requirements, because a client shareholding association has a nature similar to that of employee shareholding associations and expanded employee shareholding associations.

## **Derivative Transactions**

Q10. What is the definition of "Derivative Transactions" under the FIEA?
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- A1. Under the FIEA, "Derivative Transactions" is a collective term for "Market Transactions of Derivatives," "Over-the-Counter Transactions of Derivatives," and "Foreign Market Derivatives Transactions" (Article 2(20) of the FIEA).
- (1) "Market Transactions of Derivatives" are a certain type of Derivative Transactions conducted in a Financial Instruments Market, in accordance with requirements and by using methods prescribed by the operator of the Financial Instruments Market (Article 2(21) of the FIEA).
- (2) "Over-the-Counter Transactions of Derivatives" are a certain type of Derivative Transactions conducted in neither a Financial Instruments Market nor a foreign Financial Instruments Market (Article 2(22) of the FIEA).
- (3) "Foreign Market Derivatives Transactions" are transactions which are conducted in a Foreign Financial Instruments Market and are similar to Market Transactions of Derivatives (Article 2(23) of the FIEA).
2. "Derivative Transactions" are basically divided into the following transaction types: (1) a type of transactions where assets subject to spot transactions are used as "underlying assets"; (2) a type of transactions where numerical values, which are not subject to spot transactions themselves, are used as "reference indicators"; and (3) any other type of transactions. Specifically, the FIEA provides for the following. The types of transactions can be additionally designated by Cabinet Order (Article 2(21)(vi) and Article 2(22)(vii)).
- As type (1): futures transactions / forward transactions (Article 2(21)(i), Article 2(22)(i)), Option transactions (Article 2(21)(iii), Article 2(22)(iii)).
  - As type (2): index futures transactions / index forward transactions (Article 2(21)(ii), Article 2(22)(ii)), Option transactions (Article 2(21)(iii), Article 2(22)(iii)), index Option transactions (the portion in parentheses in Article 2(21)(iii)(b), Article 2(22)(iv)), swap transactions (Article 2(21)(iv), Article 2(22)(v)), commodity swap transactions (Article 2(21)(iv)-2).
  - As type (3): credit derivative transactions (Article 2(21)(v), Article 2(22)(vi)).
3. With regard to underlying assets of Derivative Transactions ("Financial Instruments"), the FIEA provides for Securities, deposit claims, etc., currencies, and commodities, and "assets for which there are many of the same kind, [and] which have substantial price volatility" may be designated by Cabinet Order (Article 2(24)).
4. With regard to reference indicators of "Derivative Transactions" ("Financial Indicators"), the FIEA

provides for prices or interest rates of Financial Instruments, and meteorological observation figures, and indicators where it is impossible or extremely difficult for a person to exert his/her influence on the fluctuation thereof and which may have material impact on business activities of business operators or "statistical figures pertaining to social or economic conditions" may be designated by Cabinet Order (Article 2(25)).

5. As above, the FIEA constitutes the definition of "Derivative Transactions" based on transaction types and underlying assets/reference indicators, and allows for expansion of the scope and designation by Cabinet Order of both the transaction types and underlying assets/reference indicators, from the viewpoint of filling regulatory "gaps."

Q11. What is the relationship between "Derivative Transactions" and "Securities"?

- A1. Both "Derivative Transactions" and "Securities" are regulated under the FIEA as Financial Instruments/transactions with an investment character. However, since "Securities" are instruments that indicate rights whereas "Derivative Transactions" are acts, their positioning under the FIEA differs from each other. In the case of "Securities" certain acts conducted in relation to such Securities (sales and purchases, etc.) are subject to the regulations on conducting business or the regulations on activities under the FIEA, but in the case of "Derivative Transactions," the act of such transaction itself is subject to the regulations on conducting business or the regulations on activities.
2. In addition, while "Securities" are subject to the disclosure regulation under the FIEA since they contribute to the Investment Decisions of investors, "Derivative Transactions" are not subject to the disclosure regulation. The provision of information on "Derivative Transactions" to investors is ensured through the regulations on activities relating to sales and solicitation (obligation to deliver a document, etc.).

(Note) However, among rights based on "Derivative Transactions," so-called covered warrants for which certificates are issued (Article 2(1)(xix) of the FIEA) are treated as Securities and are subject to the disclosure regulation.

Q12. Is a person registered for Financial Instruments Business eligible to conduct both so-called securities derivative transactions and financial futures transactions?

- A1. From the viewpoint of developing more comprehensive regulations, the FIEA has consolidated the various business operations that had conventionally been regulated by the individual laws governing the respective types of business into "Financial Instruments Business" (Article 2(8) of the FIEA), and has consolidated and simplified the registration procedures. As part of this measure, securities derivative transactions, which had conventionally been regulated under the Securities and Exchange Act, and financial futures transactions, which had been regulated under the Financial Futures Trading Act, were categorized as "Derivative Transactions" (Article 2(20) of the FIEA) and included within the scope of Financial Instruments Business (Article 2(8)(i) through (iv) of the FIEA).

2. Meanwhile, from the viewpoint of ensuring regulatory flexibility, the FIEA provides for the following categorization of the specific types of Derivative Transactions:

- (1) Market Transactions of Derivatives and Foreign Market Derivatives Transactions pertaining to highly liquid Securities ("Paragraph (1) Securities") and Over-the-Counter Transaction of Derivatives are categorized as "Type I Financial Instruments Business" with strict market entry requirements (requirements for registration refusal) (Article 28(1)(i) and (ii) of the FIEA); and
- (2) Market Transactions of Derivatives and Foreign Market Derivatives Transactions pertaining to less liquid Securities ("Paragraph (2) Securities") and Financial Instruments other than Securities are categorized as "Type II Financial Instruments Business" with relatively simplified market entry requirements (requirements for registration refusal) (Article 28(2)(ii) and (iii) of the FIEA).<sup>(note)</sup>

(Note) However, such Derivative Transactions that involve receipt of a security deposit from the customer are deemed as "Securities, etc. Management Business" (Article 2(8)(xvi) of the FIEA) and are categorized as "Type I Financial Instruments Business" (Article 28(1)(v) of the FIEA).

### **Public Offering, Secondary Distribution, etc.**

Q13. What is "Public Offering of Securities"?
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- A1. The Financial Instruments and Exchange Act (hereinafter referred to as the "FIEA") defines "Public Offering of Securities" (Article 2(3) of the FIEA) to be, in the case of such Securities as share certificates and corporate bond certificates ("Paragraph (1) Securities"), solicitations of applications to acquire newly issued Securities ("Solicitation for Acquisition") that are made to "a large number of persons," which is 50 or more persons.
2. Interests in collective investment schemes, etc. that are deemed as Securities under the FIEA ("Paragraph (2) Securities") are generally formed by way of determining their contents while taking into account investor demand, etc., unlike such Securities as share certificates and corporate bond certificates, etc. of which contents are fixed ("Paragraph (1) Securities"). Therefore, the FIEA defines "Public Offering" of interests in collective investment schemes, etc. to be solicitations of applications to acquire newly issued interests in collective investment schemes, etc. which will render the Securities pertaining thereto to be held by 500 or more persons who respond to such Solicitation for Acquisition (the principal sentence of Article 2(3) and Article 2(3)(iii) of the FIEA), and provides that the Public Offering is to be determined on the basis of not the number of persons solicited, but the number of persons who will hold Securities by responding to the solicitation.
  3. An act that is categorized as a "Public Offering of Securities" with a total issue value of 100 million yen or more requires submission of a Securities Registration Statement to the Prime Minister (Article 4(1) of the FIEA).

Q14. What is "Secondary Distribution of Securities"?
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- A1. The FIEA defines “Secondary Distribution of Securities” (Article 2(4) of the FIEA) to be, in the case of such Securities as share certificates and corporate bond certificates (“Paragraph (1) Securities”), solicitations of applications to sell or purchase already-issued Securities (“Solicitation for Selling, etc.”) that are made to “a large number of persons,” which is 50 or more persons.
2. In addition, the FIEA excludes from the category of “Secondary Distribution of Securities” sales and purchases of Securities on the Financial Instruments Exchange Market and the transactions equivalent thereto where investors are basically able to acquire sufficient investment information and the exclusion of such transactions from the category of Secondary Distribution is not likely to impair the protection of investors (the principal sentence of Article 2(4)), and classifies that disclosure regulation will not be applied to such transactions. Specifically, a Cabinet Order specifies sales and purchases of Securities on the Financial Instruments Exchange Market and transactions of Securities listed in a Financial Instruments Exchange through a proprietary trading system (PTS) as such excluded transactions (Article 1-7-3 of the FIEA Enforcement Order).
  3. The FIEA defines Secondary Distribution of interests in collective investment schemes, etc. that are deemed as Securities under the FIEA (“Paragraph (2) Securities”) to be solicitations of applications to sell or purchase already-issued interests in collective investment schemes, etc. (“Solicitation for Selling, etc.”) which will render the Securities pertaining thereto to be held by 500 or more persons who respond to such Solicitation for Selling, etc. (Article 2(4)(iii) of the FIEA; Article 1-8-5 of the FIEA Enforcement Order), similar to the definition of Public Offering of Paragraph (2) Securities, and provides that the Secondary Distribution is to be determined on the basis of not the number of persons solicited, but the number of persons who will hold Securities by responding to the solicitation.
  4. An act that is categorized as a “Secondary Distribution of Securities” with a total distribution value of 100 million yen or more requires submission of a Securities Registration Statement to the Prime Minister (Article 4(1) of the FIEA). Regarding a Secondary Distribution of Securities in the case where disclosures have been made with regard to the Securities, and a Secondary Distribution which satisfies certain requirements among Secondary Distributions of Securities information of which have already been disclosed in a foreign state, etc., the FIEA excludes such Secondary Distributions of Securities from an obligation to submit a Securities Registration Statement (Article 4(1)(iii) and (iv) of the FIEA).

<p>Q15. What is the outline of “Qualified Institutional Investors”?</p>
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- A. “Qualified Institutional Investors,” who are persons having expert knowledge of and experience with investment in Securities, include the following (Article 2(3)(i) of the FIEA; Article 10(1) of the Definition Ordinance):
- Financial Instruments Business Operators (limited to those that conduct Securities-Related Business or Investment Management Business)
  - Investment corporations

- Foreign investment corporations
- Banks
- Insurance companies
- Foreign insurance companies, etc.
- Shinkin banks
- Federations of Shinkin banks
- Labor banks
- Federations of labor banks
- Norinchukin Bank
- Shoko Chukin Bank
- Credit cooperatives\*
- Federations of credit cooperatives\*
- Federations of agricultural cooperatives that are able to receive deposits or savings or provide mutual aid service on a regular basis
- Federations of mutual aid fishery cooperatives
- Regional Economy Vitalization Corporation of Japan (limited to the case of purchasing claims against a business operator subject to rehabilitation, etc.)
- Rehabilitation Support Organization for Companies Damaged by the Great East Japan Earthquake (limited to the case of purchasing claims against a target business operator, etc.)
- Persons engaged in the management and investment of the fiscal loan fund
- Government Pension Investment Fund
- Japan Bank for International Cooperation
- The Okinawa Development Finance Corporation
- Development Bank of Japan
- Agricultural cooperatives that are able to receive deposits or savings on a regular basis\*\*
- Federations of fishery cooperatives that are able to receive deposits or savings on a regular basis\*\*
- Call loan brokers (limited to Registered Financial Institutions)
- Venture capitals (stated capital: 500 million yen or more)\*
- Investment LPS
- Employees' pension funds (Net Assets: 10 billion yen or more)\*
- Corporate pension funds (Net Assets: 10 billion yen or more)\*
- Pension Fund Association
- Organization for Promoting Urban Development (in the case of acquiring corporate bonds, etc. of approved business operators, etc.)
- Trust companies (excluding management-type trust companies)\*
- Foreign trust companies (excluding management-type foreign trust companies)\*
- Juridical persons (the balance of Securities held: one billion yen or more)\*

- Juridical persons which are Operating Partners, etc. of a partnership (the balance of Securities held by the partnership: one billion yen or more; and the consent of all of the other partners)\*
  - Specific Purpose Companies (the balance of Securities which are specified assets: one billion yen or more; and other requirements)\*
  - Individuals (the balance of Securities held: one billion yen or more; and one year has elapsed from the day of opening the account)\*
  - Individuals who are Operating Partners, etc. of a partnership (the balance of Securities held by the partnership: one billion yen or more; and the consent of all of the other partners)\*
  - Foreign Financial Instruments Business Operators, etc. (stated capital: more than a certain amount)\*
  - Foreign national governments, etc.\*
  - Foreign employees' pension funds (Net Assets: 10 billion yen or more)\*
- \* Limited to those that have made notification to the FSA Commissioner
- \*\* Limited to those designated by the FSA Commissioner

## **Financial Instruments Business**

**Q16. What is the definition of "Financial Instruments Business" under the FIEA?**

- A1. The FIEA has expanded the scope of business operations subject to regulations, from the viewpoint of reviewing the conventional individual laws governing the respective types of business and simplifying the regulations (developing cross-sectoral regulations) and in line with the expansion (consolidation) of the subject commodities and transactions.
2. Accordingly, the FIEA defines the regulated business as "Financial Instruments Business" (Article 2(8) of the FIEA). The fundamental business operations of "Financial Instruments Business" are "sales and solicitation," "asset investment and advice," and "asset management" (Report of the First Subcommittee).
3. In addition, the following acts are also treated as "Financial Instruments Business": solicitation by the Issuer of an application for the acquisition of its newly issued Securities (so-called self-offering) (Article 2(8)(vii) of the FIEA); agency or intermediary services for conclusion of Investment Advisory Contracts or Discretionary Investment Contracts (Article 2(8)(xiii) of the FIEA); formation of collective investment schemes, etc. and investment of funds mainly in rights pertaining to Securities or Derivative Transactions (so-called self-management)(Article 2(8)(xv) of the FIEA); acceptance of deposits of money or Securities from the customer with regard to Securities transactions, etc. (Article 2(8)(xvi) of the FIEA); and transfer of corporate bonds, etc. conducted in response to opening of an account for transfer of corporate bonds, etc. (Article 2(8)(xvii) of the FIEA).

**Q17. Are so-called self-offering and self-management covered by "Financial Instruments Business"?**

- A1. The FIEA prescribes "Public Offering or Private Placement of Securities" as an act categorized as Financial Instruments Business (Article 2(8)(vii) of the FIEA), and provides that an act of conducting self-offering (sales or solicitation by the Issuer itself) on a regular basis is categorized as Financial Instruments Business. "Public offering or Private Placement" refers to the case where the Issuer of Securities practically conducts solicitation for an application for the acquisition of its newly issued Securities ("Solicitation for Acquisition") (see Article 2(3) of the FIEA). The types of Securities subject to the "Public Offering or Private Placement" which is categorized as "Financial Instruments Business" are limited to beneficiary securities of investment trusts pertaining to beneficial interest of trust for investment based on settlor's instruction, beneficiary securities of foreign investment trusts, mortgage securities, interests in collective investment schemes, and interests in commodity funds (trust type) (Article 2(8)(vii) of the FIEA; Article 1-9-2 of the FIEA Enforcement Order), in consideration of the need for investor protection and the convenience of fund procurement by the Issuer.
2. The FIEA prescribes an act of investing money or other properties contributed from a person who holds interests in collective investment schemes, trust beneficial interests, or beneficiary securities of beneficiary securities issuing trusts mainly as an investment in Securities or rights pertaining to Derivative Transactions conducted under Investment Decisions based on analysis of values, etc. of Financial Instruments, as an act categorized as Financial Instruments Business (Article 2(8)(xv) of the FIEA). In addition, the FIEA prescribes that an act of forming collective investment schemes, etc. and investing funds mainly as an investment in Securities or Derivative Transactions (so-called self-management) is categorized as Financial Instruments Business. An act of self-management is categorized as "Investment Management Business" under the FIEA only when funds are invested mainly as an investment in Securities or rights pertaining to Derivative Transactions. An act of forming collective investment schemes, etc. and investing funds mainly as an investment in any other property, such as real estate, etc. is not categorized as "Financial Instruments Business" even if it is conducted on a regular basis.
3. A person who intends to conduct self-offering or self-management on a regular basis needs to be registered. However, when such act falls under the category of Specially Permitted Business for Qualified Institutional Investor, etc. (so-called funds for professional investors) pertaining to interests in collective investment schemes, no registration is required, and notification suffices (Article 63(1) and (2) of the FIEA). Also, when a juridical corporation conducting Investment Management Business pertaining to collective investment schemes in a foreign state conducts Investment Management Business pertaining to collective investment schemes in Japan only with Financial Instruments Business Operators or a Registered Financial Institution engaged in Investment Management Business as counterparties, no registration or notification is required (Article 61(3) of the FIEA; Article 17-11(1) of the FIEA Enforcement Order).

Q18. Is the FIEA applied to acts that are excluded from "Financial Instruments Business"?
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- A1. Whether or not the provisions of the FIEA apply to acts that are excluded from the definition of "Financial Instruments Business" should be determined in light of the purport of the respective provisions and other factors.
2. Basically, such acts are not directly subject to regulations on conducting business or regulations on activities (the obligation to deliver a document prior to and at the time of the conclusion of a contract, the obligation to prepare and deliver investment reports, etc.), and nor are they directly subject to the obligation of preparation and preservation of books and documents. For example, registration of sales representatives is presumed to be unnecessary for Over-the-Counter Transactions of non-Securities-related Derivatives, etc. conducted with professional investors as counterparties (Article 1-8-6(1)(ii) of the FIEA Enforcement Order), which are excluded from Financial Instruments Business.
  3. The FIEA limits the type of actors for some of the acts that are excluded from the definition of "Financial Instruments Business," and in such cases, only acts conducted by such actors are excluded. Thus, it is not possible to uniformly conclude that Financial Instruments Business Operators are eligible to conduct all of such acts. However, it is presumed that business operations that satisfy the requirements under individual provisions can basically be conducted as "incidental business" of Financial Instruments Business Operators (persons who conduct Type I Financial Instruments Business or Investment Management Business) (the principal sentence of Article 35(1) of the FIEA), and that such acts can be conducted without making notification of subsidiary business (Article 35(3) of the FIEA) or receiving approval for subsidiary business (Article 35(4) of the FIEA). Nevertheless, the general provisions on supervision under Article 51 of the FIEA are considered to apply to such business operations as well, so such business operations may become subject to the order to improve business operations under Article 51 of the FIEA or other measures.
  4. Also when banks, etc. conduct acts that are excluded from the definition of "Financial Instruments Business," the registration to become a Registered Financial Institution (Article 33-2 of the FIEA) is considered to be unnecessary, unless where the FIEA excludes Financial Institutions from the actors of those acts.

Q19. What is the scope of professional investors who are counterparties of Over-the-Counter Transactions of Derivatives, etc. that are excluded from "Financial Instruments Business"?

- A1. The FIEA excludes Over-the-Counter Transactions of non-Securities-related Derivatives, etc. that are conducted with persons specified by Cabinet Ordinance as those who are found to have expert knowledge of and experience with Derivative Transactions, or stock companies with a capital amount not less than the amount specified by Cabinet Ordinance as counterparties, from the definition of "Financial Instruments Business" (Article 1-8-6(1)(ii) of the FIEA Enforcement Order).
2. However, in accordance with the purport of the FIEA to ensure investor protection, the FIEA limits the scope of acts excluded from the definition of "Financial Instruments Business" to those that are

truly found not to hinder investor protection. To be more specific, the FIEA excludes acts from the definition of "Financial Instruments Business" only when the counterparties are Financial Instruments Business Operators (limited to those engaged in Type I Financial Instruments Business), Registered Financial Institutions, Qualified Institutional Investors, etc., stock companies with a capital amount of not less than one billion yen, or Specific Purpose Companies, etc. with a specified capital amount of not less than one billion yen (Article 15 of the Definition Ordinance; Public Notice of the Financial Services Agency No. 53 of 2007).

According to this, if a bank, etc. which is a Registered Financial Institution conducts over-the-counter interest rate swap transactions, etc. with a small and medium-sized company with a capital amount of less than one billion yen as the counterparty, such act is subject to regulations under the FIEA.

Q20. What kinds of acts pertaining to interests in collective investment schemes are excluded from "Financial Instruments Business"?

- A1. The FIEA treats "Public Offering or Private Placement" (so-called self-offering) of interests in collective investment schemes as Financial Instruments Business (Article 2(8)(vii)(f) of the FIEA), and regulates such act as "Type II Financial Instruments Business" (Article 28(2)(i) of the FIEA). When the Issuer of interests in collective investment schemes entrusts the Solicitation for Acquisition of said interests to an external third party and does not directly engage in the act of solicitation, the Issuer does not need to make registration or notification concerning the self-offering, since the Issuer is not conducting the "Public Offering or Private Placement."
2. Also, the FIEA treats business operations of investing money, etc. contributed from a person who holds interests in collective investment schemes mainly as an investment in Securities or Derivative Transactions (so-called self-management) as Financial Instruments Business (Article 2(8)(xv)(c) of the FIEA), and regulates such operations as Investment Management Business (Article 28(4)(iii) of the FIEA).
3. However, the FIEA excludes acts which are formally categorized as self-management but which fall under the following cases from the definition of Financial Instruments Business (Article 2(8)(xv) of the FIEA) because they are considered to have little need to be regulated as Investment Management Business (the principal sentence of Article 2(8) of the FIEA).
- (1) The first case is self-management conducted as contribution of the entire amount of capital to a single juridical person in a two-tier commodity fund scheme (Article 1-8-6(1)(iii) and Article 1-8-6(2) of the FIEA Enforcement Order). In this case, contribution is made to a single juridical person by using all of the money, etc. contributed from a person who holds beneficial interests in commodity investment. Therefore, this case satisfies such requirements as the juridical person wholly entrusting a commodities investment advisor, etc. with Investment Decisions concerning commodity investment.
- (2) The second case is self-management conducted in the case where all of the authority for

investment with regard to a collective investment scheme has been entrusted to another person (Article 1-8-6(1)(iv) of the FIEA Enforcement Order; Article 16(1)(x) of the Definition Ordinance). In this case, a person has entrusted all of the authority for investment. Therefore, this case satisfies such requirements as conclusion of a Discretionary Investment Contract with a Financial Instruments Business Operator, etc. (registered business operator), and it is a case where such Financial Instruments Business Operator, etc. has made notification of the required matters concerning said person in advance.

(3) The third case is self-management of a baby fund of a two-tiered real estate fund (Article 16(1)(xi) of the Definition Ordinance). This is a case where money, etc. contributed based on an Anonymous Partnership agreement concluded with a single counterparty (a Financial Instruments Business Operator, etc. who is a business operator of another Anonymous Partnership (a person who conducts Investment Management Business), a Specially Permitted Business Notifying Person, or a person who conducts special Investment Management Business (Article 48(1) of the Supplementary Provisions of the Act for Partial Revision of the Financial Instruments and Exchange Act (hereinafter referred to as the "Revising Act"))) is invested in beneficial interests of real estate trust. It is a case where the counterparty (a business operator of the mother fund) has made notification of the required matters concerning said person (a business operator of baby fund) in advance.

(4) The fourth case is self-management in a race horse fund scheme (Article 16(1)(xii) of the Definition Ordinance). This is a case where a person conducting "race horse investment related business operations" (Article 7(iv)(d) of the Cabinet Office Ordinance on Financial Instruments Business, etc. (hereinafter referred to as the "Financial Instruments Business Ordinance")) (such business operations refer to sales or solicitation operations pertaining to rights based on Anonymous Partnership agreements (those intended for acquiring race horses by using all of the money that has been contributed, and providing those race horses as contribution in kind to a business operator of another Anonymous Partnership, etc.)) (such person is a so-called horse-lovers corporation) makes the equity interest in said other Anonymous Partnership (a so-called club corporation) the investment target.

(5) The fifth case is self-management of a foreign collective investment scheme (Article 16(1)(xiii) of the Definition Ordinance). This is a case that satisfies such requirements as the act being conducted by a Qualified Institutional Investor or Specially Permitted Business Notifying Person where less than 10 equity investors of the foreign collective investment scheme are residents in Japan, and the amount of contribution by the residents in Japan is not more than one-third of the total amount of contribution.

4. Furthermore, the following acts of underwriting pertaining to interests in collective investment schemes are excluded from the definition of "Financial Instruments Business" (Article 2(8)(vi) of the FIEA) since there is little need to protect investors by treating such acts as "underwriting" (the principal sentence of Article 2(8) of the FIEA):

- (1) First is the act of underwriting pertaining to a lease business (Article 1-8-6(1)(iv) of the FIEA Enforcement Order; Article 16(1)(v) of the Definition Ordinance). This is a case where a Financial Instruments Business Operator (limited to a juridical person conducting Type II Financial Instruments Business, with a stated capital, etc. of 50 million yen or more) underwrites rights based on an Anonymous Partnership agreement from a wholly owned subsidiary (stock company) conducting a lease business.
- (2) Second is the act of underwriting pertaining to the formation of a two-tiered real estate fund (Article 16(1)(vi) of the Definition Ordinance). This is a case where a Financial Instruments Business Operator (limited to a juridical person conducting Type II Financial Instruments Business) underwrites equity interests in an Anonymous Partnership of a real estate private placement fund (corresponding to a so-called baby fund) for the purpose of having a business operator of another Anonymous Partnership (corresponding to a so-called mother fund) acquire those equity interests.

## Section 3 Disclosure of corporate affairs and other related matters

### Scope of application of disclosure regulation, etc.

Q1. What is the outline of disclosure regulation pertaining to issuance of Securities?

A1. In the case of procuring funds through issuance of Securities, if the act falls under the category of “Public Offering of Securities” or “Secondary Distribution of Securities” and the total issue value or the total distribution value is 100 million yen or more, solicitations for said Securities must not be made unless a Securities Registration Statement has been submitted to the Prime Minister (Article 4(1) of the FIEA).

(Note) For the definitions of “Public Offering of Securities” and “Secondary Distribution of Securities,” see Q 60 and Q61.

2. This Securities Registration Statement must contain information on the Securities subject to said Public Offering or Secondary Distribution, as well as the overview of the issuer company, the status of business, and Financial Statements, etc.
3. In addition, an issuer company or a Financial Instruments Business Operator, etc. must not have Securities acquired or sell Securities through a Public Offering or Secondary Distribution unless the Securities Registration Statement has come into effect. A Securities Registration Statement comes into effect on the day on which 15 days have elapsed from the day of its acceptance, in principle, but in the case of a company which has continuously filed Annual Securities Reports, etc. for one year or more, the statement comes into effect on the day on which seven days have elapsed from the day of its acceptance as an exceptional measure.
4. Also, an Issuer submitting a Securities Registration Statement must prepare a Prospectus stating the information contained in said statement, and when having an investor acquire Securities, the Issuer must deliver the Prospectus to the investor in advance (Article 13 and Article 15(2) of the FIEA).

Q2. What is the purpose and outline of the system of disclosing issuance of new shares, etc. through Reorganization?

A1. From the viewpoint of enhancing the system of information disclosure concerning Reorganization in light of the recent trend of Reorganization of companies, such as an increase in the number of corporate mergers and acquisitions, the FIEA imposes the same disclosure regulation as that for a Public Offering or Secondary Distribution of Securities on certain cases of the issuance of Share Certificates, etc. through Reorganization (“Procedures Relating to Securities Issuance for Reorganization”) or delivery of already-issued Share Certificates, etc. through Reorganization (“Procedures Relating to Securities Delivery for Reorganization”) (Article 2-2 and Article 4 of the FIEA). The term “Reorganization” refers to a merger, company split, share exchange, and share transfer (Article 2-2(1) of the FIEA; Article 2 of the FIEA Enforcement Order).

2. Specifically, when carrying out Procedures Relating to Securities Issuance for Reorganization or

Procedures Relating to Securities Delivery for Reorganization, the FIEA imposes an issuance disclosure obligation and a subsequent continuous disclosure obligation to the Issuer of Securities to be issued or delivered through the Procedures Relating to Securities Issuance for Reorganization or through Procedures Relating to Securities Delivery for Reorganization in the following case (the main clause and item (ii) of Article 4(1) of the FIEA): (i) where disclosure has been made with regard to Share Certificates, etc. (Article 4(1)(ii)(a) of the FIEA; Article 2-3 of the FIEA Enforcement Order) of the Reorganized Company (a company that becomes a Company Absorbed in Absorption-Type Merger, a Wholly Owned Subsidiary Company in Share Exchange, a company consolidated through a consolidation-type merger, a splitting company in an absorption-type merger, a splitting company in an incorporation-type company split, or a wholly owned subsidiary company in a share transfer) (Article 2-2(4)(i) of the FIEA; Article 2-2 of the FIEA Enforcement Order); but (ii) no disclosure has been made with regard to the Securities to be issued or delivered through the Procedures Relating to Securities Issuance for Reorganization or through the Procedures Relating to Securities Delivery for Reorganization.

3. The FIEA defines the Procedures Relating to Securities Issuance for Reorganization subject to disclosure regulation as “Specified Procedures Relating to Securities Issuance for Reorganization” (Article 2-2(4) of the FIEA) and provides that such procedures specifically refer to the following cases:

- (i) when the Securities issued through the Procedures Relating to Securities Issuance for Reorganization are Paragraph (1) Securities, such as share certificates or corporate bond certificates, etc., the case where the number of the holders of Share Certificates, etc. issued by the Reorganized Company (Article 2-2(4)(i) of the FIEA; Article 2-3 of the FIEA Enforcement Order) is 50 or more (Article 2-2(4)(i) of the FIEA; Article 2-4 of the FIEA Enforcement Order); or
- (ii) when the Securities issued through the Procedures Relating to Securities Issuance for Reorganization are Paragraph (2) Securities, such as beneficial interests of trusts, etc., the case where the number of holders of Share Certificates, etc. issued by the Reorganized Company is 500 or more (Article 2-2(4)(iii) of the FIEA; Article 2-5 of the FIEA Enforcement Order).

4. Meanwhile, the FIEA defines the Procedures Relating to Securities Delivery for Reorganization subject to disclosure regulation as “Specified Procedures Relating to Securities Delivery for Reorganization” (Article 2-2(5) of the FIEA) and provides that such procedures specifically refer to the following cases:

- (i) when the Securities issued through the Procedures Relating to Securities Delivery for Reorganization are Paragraph (1) Securities, such as share certificates or corporate bond certificates, etc., the case where the number of the holders of Share Certificates, etc. issued by the Reorganized Company is 50 or more (Article 2-2(5)(i) of the FIEA; Article 2-6 of the FIEA Enforcement Order); or
- (ii) when the Securities issued through the Procedures Relating to Securities Delivery for

Reorganization are Paragraph (2) Securities, such as beneficial interests of trusts, etc., the case where the number of holders of Share Certificates, etc. issued by the Reorganized Company is 500 or more (Article 2-2(5)(iii) of the FIEA; Article 2-7 of the FIEA Enforcement Order).

Q3. Why are so-called “securities equivalents” exempt from the application of the disclosure regulation?

- A1. The disclosure regulation based on the FIEA is intended to provide investors in general with information necessary for them to make Investment Decisions concerning Securities and protect them by obligating Issuers of Securities to submit disclosure documents with information on the Securities and Issuers, and requiring that the documents be made available for public inspection.
2. Meanwhile, interests in collective investment schemes, etc. that are deemed to be Securities under the FIEA (so-called “securities equivalents”) are generally lacking in liquidity for reasons such as that certificates of Securities are not issued and that their negotiability is limited. Therefore, the necessity of widely disclosing information concerning securities equivalents through public inspection is weak. As a result, securities equivalents are exempt from the application of the disclosure regulation (Chapter II of the FIEA) in principle (Article 3(iii) of the FIEA).
3. However, with regard to school bonds (Article 2(2)(vii) of the FIEA; Article 1-3-4 of the FIEA Enforcement Order; and Article 8 of the Definition Ordinance) as securities equivalents, it is necessary to ensure the disclosure of the creditworthiness of incorporated educational institutions, etc. that issue the bonds in order to protect investors as in the case of corporate bond certificates, etc. As a result, school bonds are subject to the application of the disclosure regulation (Article 3(iii)(c) of the FIEA; Article 2-10(2) of the FIEA Enforcement Order).

Among other items, interests in collective investment schemes, etc. that primarily invest in Securities (“Rights in Securities Investment Business, etc.”) are subject to the application of the disclosure regulation because information concerning such interests, etc. is also important for investors other than those that directly invest therein to make Investment Decisions, which means that the necessity of ensuring periodic disclosure concerning the status of investment management, etc. is strong (Article 3(iii)(a) of the FIEA and Article 2-9 of the FIEA Enforcement Order).

4. It should be noted that although securities equivalents are not subject to the application of the disclosure regulation in principle, information is provided to investors in accordance with the obligation for the delivery of a document prior to the conclusion of a contract (Article 37-3 of the FIEA), which constitutes regulation on activities of Financial Instruments Business Operators, etc.

Q4. What are “Rights in Securities Investment Business, etc.” that are subject to disclosure regulation?

- A1. Basically, “Rights in Securities Investment Business, etc.” are such “securities equivalents” as interests in collective investment schemes that invest in business “mainly conducted through investment in Securities” (Article 3(iii)(a) of the FIEA) and beneficial interests of trusts, etc. which

are rights similar to such interests in collective investment schemes (Article 3(iii)(b) of the FIEA). Rights in Securities Investment Business, etc. which exceed a certain scale are subject to application of the disclosure regulation (Article 3(iii)(b) of the FIEA).

2. The FIEA provides that the specific scope of “Rights in Securities Investment Business, etc.” is to be specified by Cabinet Order, and Cabinet Order prescribes the “business mainly conducted through investment in Securities” as follows:
  - (i) with regard to interests in collective investment schemes, the business of investing in Securities an amount exceeding 50% of the total investment in the scheme (the principal sentence of Article 2-9(1) of the FIEA Enforcement Order);
  - (ii) with regard to beneficial interests of trusts, trusts operated by investing in Securities an amount exceeding 50% of the total value of assets that belong to the trust property (the principal sentence of Article 2-10(1)(i) of the FIEA Enforcement Order); and
  - (iii) with regard to membership rights of general partnership companies, etc., business of investing in Securities an amount exceeding 50% of the total investment in the company (Article 2-10(1)(iii) of the FIEA Enforcement Order).
3. However, investments, etc. in certain juridical persons that make commodity investments are excluded from (i) above (the items of Article 2-9(1) and Article 2-9(2) of the FIEA Enforcement Order), and beneficial interests of trusts, etc. pertaining to pensions such as employees’ pension are excluded from (ii) above (Article 2-10(1)(i) and Article 2-10(3) of the FIEA Enforcement Order), and these are not subject to disclosure regulation.

Q5. In what kinds of cases is it necessary to submit a Securities Registration Statement and Annual Securities Reports for interests in investment-type collective investment schemes, etc.?

- A1. In the case of making a Public Offering or Secondary Distribution of interests in investment-type collective investment schemes, etc. (“Rights in Securities Investment Business, etc.”), the FIEA obligates submission of a Securities Registration Statement and subsequently obligates periodical submission of Annual Securities Reports (Article 24(1)(iii) of the FIEA as applied mutatis mutandis pursuant to Article 24(5) of the FIEA), similar to the case with other Securities.
2. Even in the case of not having submitted a Securities Registration Statement pertaining to a Public Offering or Secondary Distribution, the FIEA obligates the submission of Annual Securities Reports when the Public Offering or Secondary Distribution exceeds a certain scale. Specifically, even where “Solicitation for Acquisition” (Article 2(2)(iii) of the FIEA) or “Procedures Relating to Securities Issuance for Reorganization” (Article 2-2(2) of the FIEA) with regard to Rights in Securities Investment Business, etc. which are beneficial interests of trusts (Article 2(2)(i) of the FIEA), membership rights of general partnership companies, etc. (Article 2(2)(iii) of the FIEA) or interests in collective investment schemes (Article 2(2)(v) of the FIEA) do not fall under the category of “Public Offering of Securities” (Article 2(3) and Article 4(1) of the FIEA) and a Securities Registration Statement has not been submitted, an obligation to submit Annual Securities

Reports subsequently arises if the number of the holders of said Rights in Securities Investment Business, etc. becomes 500 or more, and the amount of assets, etc. pertaining to said Rights in Securities Investment Business, etc. is 100 billion yen or more (the proviso to and item (iv) of Article 24(1) of the FIEA as applied mutatis mutandis pursuant to Article 24(5) of the FIEA; Article 4-2(2) to (5) of the FIEA Enforcement Order).

3. As for the method for calculating whether the number of holders is 500 or more as mentioned above, the FIEA provides that the number to be referred to is the number of persons stated in the registry of holders for Specified Securities with the same trust property, contents of distribution claims as beneficiaries, and due date in the case of beneficial interests of trusts, the same contents of membership rights in the case of membership rights of general partnership companies, etc., or the same contents of rights of Equity Investors in the case of interests in collective investment schemes (Article 24(4) of the FIEA as applied mutatis mutandis pursuant to Article 24(5) of the FIEA; Article 26-2 of the Cabinet Office Ordinance on Disclosure of the Contents, etc. of Specified Securities).

<p><b>Q6. What is the disclosure system for the so-called asset finance-type instruments?</b></p>
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- A1. Securities subject to disclosure regulation can be divided into corporate finance-type instruments (securities) that place value in the creditworthiness of the issuing entity as a company, such as share certificates and corporate bond certificates, and asset finance-type instruments (securities) of which value is backed by assets held by the issuing entity, such as funds and asset-backed securities (ABS), according to their nature.
2. In order to ensure appropriate disclosure to investors according to the characteristics of the respective Securities, it is considered desirable to develop separate disclosure regulation for each of such Securities categories.
3. From such a viewpoint, the financial instruments legislation defines asset finance-type securities (the legal term is “Specified Securities”) as “Securities specified by Cabinet Order as those for which information that will have a material influence on investors' Investment Decisions is information on assets investment or other similar business conducted by the Issuer of the Securities” (Article 5(1) of the FIEA), and specifies their specific scope by Cabinet Order (Article 2-13 of the FIEA Enforcement Order). For such securities, the FIEA requires more detailed disclosure than for other securities concerning information on the contents of assets and information on the entity investing such assets and the contents of the investment service (Article 5(5), Article 24(5), and Article 24-5(3) and (4) of the FIEA, etc.).

<p><b>Q7. What are the requirements for exemption from the continuous disclosure obligation?</b></p>
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- A1. Even when a continuous disclosure obligation has arisen due to the submission of a Securities Registration Statement pertaining to a Public Offering or Secondary Distribution of Securities, if the Securities are not listed on a Financial Instruments Exchange and their liquidity has declined

with a decrease in the number of their holders, there will be little need to make continuous disclosure. Therefore, if such Securities have less than 25 holders, they are exempted from application of the continuous disclosure obligation by obtaining approval from the Prime Minister (the second sentence of the proviso to Article 24(1) of the FIEA; Article 4 of the FIEA Enforcement Order; Article 16(2) of the Cabinet Office Ordinance on Disclosure of Corporate Affairs).

2. Also, Securities, Share Certificates, etc. have no maturity period and it is rare for a company that has submitted a Securities Registration Statement pertaining to share certificates to have less than 25 shareholders. Therefore, companies that have submitted a Securities Registration Statement pertaining to Share Certificates, etc. are exempted from application of the continuous disclosure obligation if the public interest or protection of investors would not be impaired even if they do not submit Annual Securities Reports (the first sentence of the proviso to Article 24(1) of the FIEA).
3. Specifically, where a company needs to submit Annual Securities Reports due to having submitted a Securities Registration Statement concerning a Public Offering or Secondary Distribution of share certificates or preferred equity investment certificates (Article 3-5(1) and Article 4-10(1) of the FIEA Enforcement Order; including not only those issued by a foreign company, but also depositary receipts in the case where share certificates or preferred equity investment certificates issued by a foreign company have been brought into Japan in the form of depositary receipts), and where the number of holders (shareholders, etc.) on the last days of the five preceding business years including the current business year is less than 300 (Article 3-5(2) and Article 4-10(2) of the FIEA Enforcement Order), if the company obtains approval from the Prime Minister, it is exempted from application of the continuous disclosure obligation.
4. In the case of a Japanese company, the number of holders of Share Certificates, etc. in this case is determined based on the number of persons stated or recorded in the shareholder registry, etc. on the last day of the business year immediately prior to the business year that includes the day of application for the approval and the last days of the business years that began within four years before the day on which that immediately prior business year began (Article 15-3(2) of the Cabinet Office Ordinance on Disclosure of Corporate Affairs).

In the case of a foreign company, the determination is made as follows.

- (i) In the case of a foreign company whose share certificates have been listed on a Japanese Financial Instruments Exchange in the past and are currently listed on a Foreign Financial Instruments Market, the number is determined based on the number of persons who had held share certificates of said foreign company on the day of the delisting from the Japanese Financial Instruments Exchange and who have continued to hold the share certificates after the delisting (Article 15-3(3)(i) of the Cabinet Office Ordinance on Disclosure of Corporate Affairs).
- (ii) In the case of a foreign company whose share certificates have never been listed on a Japanese Financial Instruments Exchange and are currently listed on a Foreign Financial Instruments Market, the number is determined based on the number of persons who have acquired share

certificates of said foreign company through a Public Offering or Secondary Distribution and who have continued to hold the share certificates thereafter (Article 15-3(3)(ii) of the Cabinet Office Ordinance on Disclosure of Corporate Affairs).

- (iii) In the case of a foreign company whose share certificates are not listed on a Foreign Financial Instruments Market, the number is determined based on the number of all persons who hold share certificates of said foreign company in Japan (the main clause of Article 15-3(3) of the Cabinet Office Ordinance on Disclosure of Corporate Affairs).

## Quarterly disclosure

Q8. What is the quarterly disclosure system?
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- A1. The FIEA provides that companies subject to the quarterly reporting system are Issuers whose Share Certificates, etc. are listed on a Financial Instruments Exchange or registered with an over-the-counter market (Article 24-4-7(1) of the FIEA; Article 4-2-10(1) of the FIEA Enforcement Order).
2. The contents of disclosure under the quarterly reporting system (“Matters to Be Stated in a Quarterly Securities Report”) are specified by Cabinet Office Ordinance; they are basically information on a consolidated basis such as Quarterly Consolidated Financial Statements (Article 24-4-7(1) of the FIEA; Article 17-15(1), Form 4-3 for Japanese companies and Form 49-3 for foreign companies of the Cabinet Office Ordinance on Disclosure of Corporate Affairs). However, the report for the second quarter to be submitted by companies that engage in business specified by Cabinet Office Ordinance such as banks and insurance companies (“Company Engaged in a Specified Business”) (Article 17-15(2) of the Cabinet Office Ordinance on Disclosure of Corporate Affairs) must include not only information on a consolidated basis (“Matters to Be Stated in a Quarterly Securities Report”), but also non-consolidated Interim Financial Statements, etc. (Article 24-4-7(1) of the FIEA; Article 17-6(1) of the Cabinet Office Ordinance on Disclosure of Corporate Affairs). Disclosure of such information is required because such information is also considered to be important investment information for investors in the case of companies that are subject to a capital adequacy ratio regulation or the like on a non-consolidated, semiannual basis.
3. Quarterly Consolidated Financial Statements and Quarterly Financial Statements must undergo an audit certification by a certified public accountant or auditing firm, and the specific procedures, etc. are provided by the Cabinet Office Ordinance on Audit Certification of Financial Statements, etc. (Article 193-2(1) of the FIEA; Article 3 of the Cabinet Office Ordinance on Audit Certification of Financial Statements, etc.).
4. The time limit for submitting a Quarterly Securities Report is within 45 days from the end of a quarter (Article 24-4-7(1) of the FIEA; Article 4-2-10(3) of the FIEA Enforcement Order). However, the time limit for Companies Engaged in a Specified Business, such as banks and insurance companies, to submit a Quarterly Securities Report for the second quarter is within 60

days from the end of the second quarter, because they also need to disclose non-consolidated Interim Financial Statements, etc. (Article 24-4-7(1) of the FIEA; Article 4-2-10(4)(i) of the FIEA Enforcement Order).

5. A Quarterly Securities Report is made available for public inspection for three years from the day of submission, as in the case of a Semiannual Securities Report (Article 25(1)(vii) of the FIEA).

Q9. Which companies are obligated to submit Quarterly Securities Reports?
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- A1. The purpose of the quarterly disclosure is to provide information on the business performance, etc. of a company to investors in a more timely manner as information that contributes to making Investment Decisions regarding the company.
2. Companies for which information on business performance, etc. needs to be provided more frequently as investment information are considered to be companies in a high-liquidity trading market where a wide range of investors are expected to participate. Therefore, it is appropriate to make companies whose Securities are listed on a Financial Instruments Exchange or registered with an over-the-counter market subject to the quarterly reporting system, in principle. Cabinet Order provides for Issuers who have the following Securities listed on a Financial Instruments Exchange or registered with an over-the-counter market as target companies (Article 24-4-7(1) of the FIEA; Article 4-2-10(1) of the FIEA Enforcement Order):
- (i) share certificates;
  - (ii) preferred equity investment certificates;
  - (iii) Securities issued by a foreign entity which have characteristics of the Securities set forth in (i) or (ii) above;
  - (iv) beneficiary securities of a Securities trust (Article 2-3(iii) of the FIEA Enforcement Order) of which the entrusted Securities are any of the Securities set forth in (i) through (iii) above; and
  - (v) depositary receipts which indicate rights pertaining to any of the Securities set forth in (i) through (iii) above.
3. A company submitting an Annual Securities Report may voluntarily submit Quarterly Securities Reports even if its Securities are not listed on a Financial Instruments Exchange or registered with an over-the-counter market (Article 24-4-7(2) of the FIEA). However, an Issuer of Specified Securities (Article 5(1) of the FIEA; Article 2-13 of the FIEA Enforcement Order) may not submit Quarterly Securities Reports even voluntarily.

Q10. Are foreign companies also obligated to submit Quarterly Securities Reports?
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- A. Foreign companies are also obligated to submit Quarterly Securities Reports as in the case of Japanese companies if Share Certificates, etc. they have issued are listed on a Financial Instruments Exchange or registered on an over-the-counter market in Japan (Article 24-4-7(1) of the FIEA; Article 4-2-10(1)(iii) through (v) of the FIEA Enforcement Order).

**Q11. Are there penal provisions concerning Quarterly Securities Reports?**

- A1. A person who submits a Quarterly Securities Report containing false statements on important matters is punished by imprisonment with work for not more than five years or a fine of not more than five million yen, or both (individual) and a fine of not more than 500 million yen (juridical person) (Article 197-2(vi) and Article 207(1)(ii) of the FIEA). A person who fails to submit a Quarterly Securities Report is punished by imprisonment with work for not more than one year or a fine of not more than one million yen, or both (individual) and a fine of not more than 100 million yen (juridical person) (Article 200(v) and Article 207(1)(v) of the FIEA).
2. In addition, a person who submits a Quarterly Securities Report containing false statements on important matters must pay an Administrative Monetary Penalty (Article 172-4(2) of the FIEA).

**Internal control over financial reporting**

**Q12. Why was the Internal Control Report system introduced?**

- A1. In order for the Securities market to fully demonstrate its functions, it is indispensable that corporate information is properly disclosed to investors. However, incidents of inappropriate corporate financial disclosure have occurred in succession recently. It has been pointed out that companies' internal control over financial reporting may not have been functioning effectively in such incidents. Enhancement of internal control over financial reporting is an important task for ensuring proper disclosure.
2. From such viewpoint, the FIEA introduced the Internal Control Report system as a measure to enhance internal control over financial reporting (Article 24-4-4 and Article 193-2(2) of the FIEA). The Internal Control Report system obligates Listed Companies, etc. to ensure that assessment by the management and audit by a certified public accountant or an audit firm are conducted with regard to the effectiveness of the internal control over financial reporting.

**Q13. What are the details of the Internal Control Report system, and from when is it applied?**

- A1. Cabinet Order provides that listed companies (see Article 24(1)(i) of the FIEA) are basically the entities subject to the Internal Control Report system (Article 24-4-4(1) of the FIEA; Article 4-2-7(1) of the FIEA Enforcement Order).
2. As for the matters to be disclosed under the Internal Control Report system, an Internal Control Report containing the results of assessment of the system necessary for ensuring appropriateness of documents on finance and accounting and other information (prepared on a consolidated basis) is to be submitted together with the Annual Securities Report (Article 24-4-4(1) of the FIEA). The matters to be stated in the Internal Control Report are specified by Cabinet Office Ordinance. Specifically, they are as follows: (1) matters concerning the basic framework of the internal control over financial reporting; (2) matters concerning the scope, Reference Date, and procedure of the assessment; (3) matters concerning the assessment results; and (4) supplementary matters (Article

24-4-4(1) of the FIEA; Article 4 and the item (i) form of the Cabinet Office Ordinance on the System for Ensuring Appropriateness of Documents on Finance Calculation and Other Information (hereinafter referred to as the "Internal Control Ordinance").

3. The Internal Control Report is required to undergo an audit process (internal control audit) by a certified public accountant or an audit firm and receive the certification (Article 193-2(2) of the FIEA).

4. The Internal Control Report and other disclosure documents are to be made available for public inspection for five years from the date of their submission (Article 25(1)(vi) of the FIEA).

5 The provisions on the Internal Control Report system came into effect on September 30, 2007 (the date of enforcement of the FIEA), and have been applied to business years starting on or after April 1, 2008 (Article 15 of the Supplementary Provisions of the Revising Act).

Q14. What is the scope of companies that are obligated to submit an Internal Control Report?
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- A1. Since the purpose of introduction of the Internal Control Report system is to ensure proper disclosure of corporate information to investors, it is appropriate to apply the system basically to companies listed on highly liquid secondary markets where a broad range of investors are to invest. Accordingly, the target companies are to be companies whose Securities, such as share certificates and preferred equity securities, are listed and traded on securities markets or over-the-counter markets (including Cooperative Structured Financial Institutions) (Article 24-4-4(1) of the FIEA; Article 4-2-7(1) of the FIEA Enforcement Order).
2. A company submitting an Annual Securities Report (excluding such report pertaining to a certain type of securities) may submit an Internal Control Report voluntarily, even if it is not a listed company, etc. (Article 24-4-4(2) of the FIEA).

Q15. Are foreign companies also obligated to submit an Internal Control Report?
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- A1. If a foreign company is a listed company, etc. in Japan, it is obligated to submit an Internal Control Report and documents to be attached thereto, as in the case of a Japanese company (Article 24-4-4(1) and (4) of the FIEA; Article 4-2-7(1)(iii) through (v) of the FIEA Enforcement Order).
2. In certain cases, such as where the Commissioner of the Financial Services Agency gives approval, a foreign company may submit a report assessing the internal control over financial reporting that has been disclosed in its home country, etc. as the Internal Control Report (Article 24-4-4(1) of the FIEA; Article 11 of the Internal Control Ordinance).
3. In certain cases, a foreign company submitting an Annual Securities Report in Japan may submit documents stating the matters to be stated in an Internal Control Report, etc. which are prepared in English, in lieu of an Internal Control Report and other related documents prepared in Japanese (Article 24-4-4(6) of the FIEA). In order to implement this provision, required revisions will be made to relevant Cabinet Orders and Cabinet Office Ordinances in around spring of 2008.

**Q16. What are the standards for assessment and audit of the internal control over financial reporting?**

- A1. The FIEA and regulations provide that, when preparing an Internal Control Report and an internal control audit report (a report on audit certification of the Internal Control Report), matters not specified by Cabinet Office Ordinance should be stated in accordance with the "generally accepted assessment standards for the internal control over financial reporting" and the "generally accepted audit standards and practices for the internal control over financial reporting" (Article 24-4-4(1) and Article 193-2(2) of the FIEA; Article 1(1) and (3) of the Internal Control Ordinance).
2. The standards and the practice standards published by the Business Accounting Council are regarded as generally accepted assessment and audit standards for the internal control (Article 1(4) of the Internal Control Ordinance).
  3. On February 15, 2007, the Business Accounting Council compiled and published "On the Setting of the Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting."
  4. The standards and practice standards for assessment and audit concerning internal control over financial reporting consist of three sections: "I. Basic Framework of Internal Control," "II. Assessment and Report on Internal Control Over Financial Reporting," and "III. Audit on Internal Control Over Financial Reporting." The practice standards cite the standards and indicate practical guidance concerning the cited standards.
  5. The outline of the standards and practice standards for assessment and audit concerning internal control over financial reporting is as follows:

**(1) Basic framework of internal control**

Internal control is a process basically performed in order to provide reasonable assurance of achieving four objectives: (i) effectiveness and efficiency of business operations, (ii) reliability of financial reporting, (iii) compliance with applicable laws and regulations relevant to business activities, and (iv) safeguard of assets. Internal control consists of six basic components: (i) control environment, (ii) risk assessment and response, (iii) control activities, (iv) information and communication, (v) monitoring, and (vi) response to IT.

**(2) Assessment and report on internal control over financial reporting**

Management has the role and responsibility to design and operate internal control. It is particularly vital for management to assess the effectiveness of the internal control over financial reporting and report its conclusion externally. In evaluating the effectiveness of internal controls, management should first assess internal controls that have a material impact on overall consolidated financial reporting ("company-level controls") and, based on the results, assess the "operational process-level controls." Management is then to prepare an "Internal Control Report" and state the results of said assessment on the effectiveness of the internal controls over financial reporting, etc. (such as "effective" or "not effective due to the presence of material deficiencies that should be disclosed").

**(3) Audit on internal control over financial reporting**

The auditors audit the results of the management's assessment of the effectiveness of internal control over financial reporting. They first examine the appropriateness of the scope of assessment as determined by the management, and then examine the management's assessment of company-level controls and the assessment of operational process-level controls performed by the management based on the result of assessments of company-level controls. The auditors prepare an "internal control audit report" and express their opinion ("unqualified opinion," "qualified opinion," or "adverse opinion") and other matters therein.

Q17. What was the background behind the establishment of the standards and practice standards for assessment and audit concerning internal control over financial reporting?

- A1. In order to ensure appropriate implementation of assessment of the effectiveness of internal control over financial reporting and audit by a certified public accountant or an audit firm in practice, it is necessary to formulate assessment/audit standards and practical guidance.
2. From such viewpoint, the Internal Control Committee (chair: Shinji Hatta, professor, Aoyama Gakuin University) of the Business Accounting Council studied the details of internal control practices in Japanese companies as well as internal control standards in the United States and other countries, and made deliberations. On December 8, 2005, the committee compiled "Draft Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting." At that time, many comments were offered requesting development of a set of practical guidance (practice standards) which will assist in application of the standards to actual practice. Therefore, a task force was set up within the committee, and discussions were held on draft practice standards.
  3. Following such discussions, on February 15, 2007, the Business Accounting Council (chair: Hideyoshi Ando, professor, Hitotsubashi University) finally published "About the Setting of the Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting (Council' Opinion)."

Q18. What points should be kept in mind when operating the standards and practice standards for assessment and audit concerning internal control over financial reporting?

- A1. Ensuring proper disclosure is primarily the responsibility of management, and management has the role and responsibility to design and operate internal control. From such viewpoint, the design and operation of internal control should not be uniform, but should vary by company, in accordance with the environment surrounding the company, the characteristics of its business, its size, etc. Management is expected to undertake appropriate efforts to effectively fulfill the functions and the roles of internal controls in accordance with the specific circumstances of the company.
2. In designing the Internal Control Report system, the important point of how the system should be efficiently operated while securing its effectiveness was discussed. Therefore, with regard to operation of the standards and practice standards, very specific guidelines are indicated for the development, assessment, and audit of internal control over financial reporting, including

indication of numerical examples (such as the guideline for determining a "material deficiency that should be disclosed" (around 5% of consolidated pretax profit)), while taking into account the opinions of people who are actually engaged in such assessment or audit and maintaining the basic idea of respecting the original efforts of the individual companies.

3. Meanwhile, the following points need to be kept in mind upon operation of the standards and practice standards:

- (1) the basic idea indicated in the standards and practice standards should be observed sufficiently, and the standards and practice standards should not be applied in a formal, uniform, or inflexible manner deviating from the basic idea;
- (2) since the standards and practice standards have been prepared to be commonly applied to all companies, how internal control should be designed and operated in accordance with the type of business and the company's characteristics should be determined based on the original efforts of the individual companies.

Q19. What is the scope of "internal control over financial reporting"?
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A1. The Internal Control Report system introduced by the FIEA requires assessment by management and audit by auditors with a specific focus on "internal control over financial reporting," from the viewpoint of ensuring proper disclosure. Therefore, if the internal control system developed by a company also covers processes other than financial reporting, the part of the system irrelevant to financial reporting is not subject to the assessment and audit.

2. "Financial reporting" is external reporting of both 1) financial statements and 2) disclosure information and others that could have a material effect on the reliability of financial statements. "Internal control over financial reporting" is the system to ensure that financial reporting in a company is properly prepared according to laws and regulations (Article 24-4-4(1) of the FIEA; Article 2(i) and (ii) of the Internal Control Ordinance).

3 The practice standards specifically indicate the scope of financial statements and disclosure information and others that could have a material effect on the reliability of financial statements. Other than financial statements, the following are mentioned as matters covered by the scope: (1) disclosure information to be provided as a summary, excerpt, or breakdown of the values presented in the financial statements; and (2) matters that are closely related to the decision of whether an entity is an affiliate, decision on the scope of consolidation, and other decisions involved in preparing the financial statements.

Q20. How does the Japanese Internal Control Report system differ from the Internal Control Report system pertaining to financial reporting that was introduced in the United States by the Sarbanes–Oxley Act of 2002?
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A1. The U.S. Internal Control Report system under Section 404 of the Sarbanes–Oxley Act of 2002 (SOX) requires that the companies registered with the U.S. Securities and Exchange Commission

(SEC) include an Internal Control Report stating the results of assessment of the effectiveness of internal control over financial reporting in the annual report, and that such Internal Control Report undergo audit by an auditor. It is presumed that there is hardly any difference in the basic framework of the Japanese and U.S. systems.

2. In the United States, the Internal Control Report system has been acclaimed to contribute to raising the awareness of the management, enhancing investors' confidence in financial reporting, and increasing the efficiency of companies' business operations. At the same time, however, it has been pointed out that the cost of assessment and audit is swelling, and is affecting the international competitiveness of the U.S. capital market. Accordingly, in June 2007, the U.S. SEC newly formulated and put into effect guidance on management assessment, and in July 2007, the Public Company Accounting Oversight Board (PCAOB) reviewed the system, including revision of the audit standards.
3. Due to such circumstances, when the Business Accounting Council developed the standards and practice standards, it verified the status of operation of the system that was already being introduced in the United States, and incorporated the following measures so as to prevent an excessive cost burden:
  - (1) Using top-down/risk-based approach  
Operational process-level controls are assessed based on the assessment of the results of company-level controls (internal controls that have a material impact on overall consolidated financial reporting), focusing on the risks that could create material misstatements.
  - (2) Simplifying classification of deficiencies of internal controls  
Classification of deficiencies in internal control was simplified into two categories: "material deficiencies that should be disclosed" and "deficiencies" (the deficiencies are classified into three categories in the United States: "material weakness," "significant deficiencies," and "deficiencies").
  - (3) Not adopting direct reporting  
Audit is conducted only on assessment of the internal control that has been conducted by management. The direct reporting, which was adopted in parallel with the audit of management's assessment in the United States at first and where auditors directly assess the internal control (audit irrelevant to management's assessment), was not adopted in Japan. (Later, based on PCAOB's new auditing standard (Auditing Standard No. 5; approved by SEC in July 2007), the United States abolished audit on management's assessment of the internal control, and adopted direct reporting only.)
  - (4) Integrated implementation of internal control audit and audit of financial statements  
Internal control audits are to be performed by the same auditors responsible for auditing the company's financial statements, in principle. Audit evidence obtained in an audit may be used in both audits. (In the United States, the two audits must be performed by the same audit firm, but not necessarily by the same auditors.)

(5) Preparation of internal control audit report and financial statement audit report in a unified form  
The internal control audit report is, in principle, to be prepared in conjunction with the report of financial statements audit.

(6) Coordination between auditors and audit committee / internal auditors

Auditors are to appropriately coordinate with the audit committee, etc. and, when necessary, make use of the work of internal auditors.

**Q21. Are there penal provisions against those who violate provisions of Internal Control Reports?**

A. When a person submits an Internal Control Report including a misstatement on important matters or fails to submit an Internal Control Report, the person is punished by imprisonment with work for not more than five years or by a fine of not more than five million yen, or both (in the case of an individual) or a fine of not more than 500 million yen (in the case of a juridical person) (Article 197-2(v) and (vi) and Article 207(1)(ii) of the FIEA).

## **Confirmation Letter**

**Q22. Why was the Confirmation Letter system introduced concerning the contents of Annual Securities Reports, etc.?**

- A1. In light of the recent cases of inappropriate practices related to disclosure, the Internal Control Report system was introduced under the FIEA in order to enhance internal control over financial reporting by Listed Companies, etc.
2. On the premise of developing an effective internal control system, the Confirmation Letter system aims to enhance the appropriateness of Annual Securities Reports, etc. by obligating the management themselves to confirm the appropriateness of the contents thereof and attach to Annual Securities Reports, etc. a Confirmation Letter containing a statement to that effect (Article 24-4-2, Article 24-4-8 and Article 24-5-2 of the FIEA).
3. As the new Confirmation Letter system became applicable for business years starting on April 1, 2008, and later, the previous voluntary Confirmation Letter system (introduced in April 2003) was abolished. However, it is prescribed that when a Confirmation Letter is attached to Annual Securities Reports, etc. submitted on or before March 31, 2008, the procedures under the previous system should be followed (Article 3(1) through (3) of the Supplementary Provisions of the Cabinet Office Ordinance for Partial Revision of the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc.), so a Confirmation Letter may therefore be attached to Annual Securities Reports, etc. submitted by then on a voluntary basis.

**Q23. What kind of system is the Confirmation Letter system?**

- A1. Companies subject to the Confirmation Letter system are specified by Cabinet Order and they are basically listed companies (see Article 24(1)(i) of the FIEA) as in the case of the Internal Control

Report system (Article 24-4-2(1), Article 24-4-8(1) and Article 24-5-2(1) of the FIEA; Article 4-2-5(1) of the FIEA Enforcement Order).

2. With regard to the contents of a Confirmation Letter, a letter confirming that statements contained in the Annual Securities Reports, etc. are appropriate under the Financial Instruments and Exchange Act and Related Regulations is to be submitted together with Annual Securities Reports, etc. (Article 24-4-2(1) of the FIEA, etc.).
3. A Confirmation Letter is to be provided for public inspection for five years from the day of submission (Article 25(1)(v) of the FIEA).

Q24. Which companies are obligated to submit Confirmation Letters?
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- A1. The purpose of introducing the Confirmation Letter system is to ensure proper disclosure of corporate information. Therefore, it is appropriate to target listed companies whose Securities are listed on a high-liquidity trading market where a wide range of investors are expected to participate, as in the case of the Internal Control Report system. From such a viewpoint, the FIEA makes companies (including Cooperative Structured Financial Institutions) whose Securities, such as share certificates and preferred equity investment certificates, are listed on a Financial Instruments Exchange or registered with an over-the-counter market subject to the Confirmation Letter system (Article 24-4-2(1), Article 24-4-8(1) and Article 24-5-2(1) of the FIEA; Article 4-2-5(1) of the FIEA Enforcement Order).
2. A company submitting an Annual Securities Report (excluding a report pertaining to Specified Securities) may voluntarily submit Confirmation Letters even if the company is not a Listed Company, etc. (Article 24-4-2(2), Article 24-4-8(1) and Article 24-5-2(1) of the FIEA).

Q25. Are foreign companies also obligated to submit Confirmation Letters?
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- A1. Foreign companies are also obligated to submit Confirmation Letters as in the case of Japanese companies, if they are Listed Companies, etc. (Article 24-4-2(1) of the FIEA).
2. In certain cases, foreign companies (“Reporting Foreign Companies”) may submit, instead of Confirmation Letters, documents which are prepared in English and which contain matters to be stated in Confirmation Letters (Article 24-4-2(6) of the FIEA). In order to implement this provision, necessary revisions are to be made to Cabinet Order and Cabinet Office Ordinance in around spring of 2008.

Q26. What kinds of disclosure documents require submission of a Confirmation Letter?
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- A1. Disclosure documents for which a Confirmation Letter must be submitted together are (i) Annual Securities Reports (Article 24-4-2 of the FIEA), (ii) Quarterly Securities Reports (Article 24-4-8 of the FIEA) and (iii) Semiannual Securities Reports (Article 24-5-2 of the FIEA).
2. Also when a company submits an amendment report for its Annual Securities Report, Quarterly Securities Report or Semiannual Securities Report, the company needs to submit a Confirmation

Letter with regard the amendment report together (Article 24-4-2(4), Article 24-4-8(1) and Article 24-5-2(1) of the FIEA).

Q27. Which members of the management need to include their titles and names in the Confirmation Letter?

A. The form of and the matters to be stated in a Confirmation Letter are specified by Cabinet Office Ordinance (Article 24-4-2(1), Article 24-4-8(1) and Article 24-5-2(1) of the FIEA). It is provided that members of the management whose titles and names must be included in a Confirmation Letter are the representative person(s) (representative director/representative executive officer) of the company submitting Annual Securities Reports, etc. and, in the case where the company has appointed the chief financial officer as a person with responsibilities equivalent to those of the representative person with regard to financial reporting, said chief financial officer (Article 17-5(1)(i) and Points to Note in Preparing Statements (3) and (4) of Form 4-2 of the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc.). The inclusion of the title and name of the chief financial officer also applies to Internal Control Reports (Article 24-4-4(1) of the FIEA; Article 4(i) and Points to Note in Preparing Statements (4) of Form 1 of the Internal Control Ordinance).

Q28. How does a Confirmation Letter differ from a written oath of the management submitted under self-regulation of a Financial Instruments Exchange?

A1. Under self-regulation of a Financial Instruments Exchange, listed companies are required to submit the following (e.g., Article 418 and Article 421 of the Securities Listing Regulations of the Tokyo Stock Exchange):

- (i) a document stating matters including the fact that the company recognizes that the Annual Securities Reports, etc. contain no false statements (a “confirmation document on the adequacy of Annual Securities Reports, etc.”); and
- (ii) a “written oath pertaining to proper disclosure” in which the company makes an oath that it will take a sincere attitude in the appropriate and timely provision of corporate information to investors, etc.

2. Of these, the “confirmation document on the adequacy of Annual Securities Reports, etc.” in (i) above resembles the Confirmation Letter system introduced under the FIEA. While the effectiveness of the Confirmation Letter system under the FIEA is ensured by such measures as an order by the administration to submit an amendment Confirmation Letter (Article 24-4-3(1) of the FIEA), the effectiveness of the confirmation document of the Exchange is ensured by such methods as a request by the Exchange for the company to submit an improvement report (e.g., Article 502 of the Securities Listing Regulations of the Tokyo Stock Exchange).

Q29. Are there penal provisions concerning Confirmation Letters?

A1. A person who fails to submit a Confirmation Letter is punished by a non-criminal fine of not more

than 300,000 yen (Article 208(ii) of the FIEA).

2. If penal provisions were imposed in the case of having submitted a Confirmation Letter stating that contents of the Annual Securities Reports, etc. are proper while knowing that they contain false statements, the requirement for constitution of the crime would basically overlap with those of penal provisions in the case of having submitted Annual Securities Reports, etc. containing false statements on important matters. Therefore, in the case of having submitted a Confirmation Letter containing false statements, the penal provisions for the case of having submitted Annual Securities Reports, etc. containing false statements (Article 197(1)(i), Article 197-2(vi) and Article 207(1)(i) and (ii) of the FIEA) are applied, instead of providing for individual penal provisions for such a case.

## Section 4 Tender Offer regulation

### Q1. What is the Tender Offer regulation?

- A1. Tender Offer refers to an act of offers for Purchase, etc. or soliciting offer for Sales, etc. of Share Certificates, etc. from many and unspecified persons through public notice, and making Purchase, etc. of Share Certificates, etc. outside of Financial Instruments Exchange Markets (Article 27-2(6) of the FIEA).
2. Specifically, in order to secure transparency and fairness of securities trading that affects the controlling interest in the company, the FIEA obligates the following, mainly in the case of making Purchase, etc. of a large amount of Share Certificates, etc. outside of Financial Instruments Exchange Markets: (i) the Tender Offeror must disclose the Tender Offer Period, the volume to be purchased, the Tender Offer Price, etc. in advance; and (ii) the Tender Offeror must provide shareholders a fair opportunity to sell Share Certificates, etc.

### Q2. Which specific transactions are subject to application of the Tender Offer regulation?

- A1. The following three points represent the basic aspects for demarcating the scope of application of the Tender Offer regulation:
- (i) the target of the regulation is the Purchase, etc. of Share Certificates, etc. outside of Financial Instruments Exchange Markets, in principle;
  - (ii) small-scale transactions, which are considered to have little impact on the controlling interest in the company, are excluded from the regulation; and
  - (iii) since Purchases, etc. from an extremely small number of persons cannot be discussed on the same ground as Purchases, etc. by many and unspecified persons in terms of the need for widely disclosing information and for giving shareholders an opportunity for Purchase, etc., differences are established in the percentage of the Share Certificates, etc. Holding Rate after the Purchase, etc. that is subject to application of the Tender Offer regulation.
2. Specifically, the FIEA provides that the following Purchases, etc. of Share Certificates, etc. are to be made by means of Tender Offer (Article 27-2(1) of the FIEA), and additionally provides for exceptions (the proviso to Article 27-2(1) of the FIEA; Article 6-2(1) of the FIEA Enforcement Order; see Q 116):
- (i) the case where the Share Certificates, etc. Holding Rate after the Purchase, etc. of Share Certificates, etc. outside of Financial Instruments Exchange Markets exceeds 5% (excluding transactions at an Over-the-Counter Securities Market and Purchases, etc. from an extremely small number of persons [ten persons or less during a period of 60 days]) (Article 27-2(1)(i) of the FIEA; Article 6-2(2) and (3) of the FIEA Enforcement Order);
  - (ii) Purchases, etc. of Share Certificates, etc. from an extremely small number of persons outside of Financial Instruments Exchange Markets where the Share Certificates, etc. Holding Rate exceeds one-third of the outstanding total (Article 27-2(1)(ii) of the FIEA);

- (iii) Purchases, etc. using the method of Specified Sales and Purchase, etc. (off-floor trading) at a Financial Instruments Exchange Market where the Share Certificates, etc. Holding Rate exceeds one-third (Article 27-2(1)(iii) of the FIEA);
- (iv) rapid Purchases, etc. where a combination of Purchases at or outside of Financial Instruments Exchange Markets and Acquisition of Newly Issued Share Certificates, etc. (acquisition of Share Certificates, etc. which is newly issued by its Issuer) are made in excess of a certain proportion during a period of three months and where the Share Certificates, etc. Holding Rate after these transactions exceeds one-third (Article 27-2(1)(iv) of the FIEA);
- (v) Purchase, etc. of Share Certificates, etc. in excess of a certain portion by a holder whose Share Certificates, etc. Holding Rate exceeds one-third during the period of another person's Tender Offer (Article 27-2(1)(v) of the FIEA); and
- (vi) the case of applying (iv) above by deeming the acquisition of Share Certificates, etc. by Specific Interested Parties of the purchaser of Share Certificates, etc. as acquisition of Share Certificates, etc. by the Tender Offeror (Article 27-2(1)(vi) of the FIEA; Article 7(7) of the FIEA Enforcement Order).

Q3. What is the treatment for purchases combining transactions at and outside of Financial Instruments Exchange Markets?

- A1. Purchases, etc. of Share Certificates, etc. outside of Financial Instruments Exchange Markets are, even if they are Purchases, etc. from an extremely small number of persons (ten persons or less during a period of 60 days), obligated to be made by means of a Tender Offer if the Share Certificates, etc. Holding Rate after the purchase exceeds one-third (the so-called "one-third rule") (Article 27-2(1)(ii) of the FIEA; Article 6-2(3) of the FIEA Enforcement Order). However, there can be persons who try to acquire Share Certificates, etc. exceeding one-third without using the means of a Tender Offer by purchasing shares up to 32% outside the market, and subsequently acquiring shares of 2% by purchasing them at the market or receiving third-party allocation of new shares.
2. In order to deal with such law-evading style of transactions, the FIEA clearly provides that the case of rapid Purchases, etc. combining Purchases, etc. at and outside of Financial Instruments Exchange Markets where the subsequent Share Certificates, etc. Holding Rate exceeds one-third is subject to Tender Offer regulation (Article 27-2(1)(iv) of the FIEA).
  3. The specific style of rapid Purchases, etc. that are subject to regulation is the case where the Share Certificates, etc. Holding Rate exceeds one-third by making, within a period of three months, acquisition of Share Certificates, etc. where Purchases, etc. (excluding those by means of a Tender Offer and those excluded from application of the regulation as provided for in the proviso to Article 27-2(1) of the FIEA) outside of Financial Instruments Exchange Markets (including off-floor trading) exceeds 5% and where acquisition in excess of 10% is made through Purchases, etc. at or outside of Financial Instruments Exchange Markets or Acquisition of Newly Issued Share

Certificates, etc. (acquisition of Share Certificates, etc. which is newly issued by its Issuer) as a whole (Article 7(2) through (4) of the FIEA Enforcement Order).

Q4. For example, in cases where the purchaser has purchased a volume of Share Certificates, etc. equivalent to more than 5% of the outstanding total outside of Financial Instruments Exchange Markets through means other than a Tender Offer and where it plans to conduct an additional purchase within three months in order to increase the Share Certificates, etc. Holding Rate to more than one-third, would it be sufficient to conduct the additional purchase through a Tender Offer?

- A1. When Article 27-2(1)(iv) of the FIEA is applied, Purchases, etc. conducted within three months of each other (Article 7(2) of the FIEA Enforcement Order) are recognized as one purchase.
2. Consequently, in the case in question, if the combined purchase volumes of the first and second Purchases, etc. would exceed 10% of the outstanding total, it would not be sufficient to conduct the second Purchase, etc. through a Tender Offer. The first Purchase, etc. should also have been conducted through a Tender Offer.
  3. If the first transaction has already been conducted, the second transaction can be conducted only after the passage of three months.
  4. In light of the nature of this regulation, when a transaction is conducted outside of Financial Instruments Exchange Markets, it is necessary to make a careful judgment as to whether or not it is necessary to do so through a Tender Offer after examining the schedule of future transactions, etc.

Q5. What is the treatment for the case where another person makes purchases during a period when a Tender Offer is conducted?

- A1. When Purchases, etc. of Share Certificates, etc. that affect the controlling interest in a company are competing against one another, general investors would have to make more complicated Investment Decisions and there would be concerns that shareholders other than the competing parties would be forced into a non-significant standing. Therefore, a person who makes competitive Purchases, etc. during a period in which another person is conducting a Tender Offer is also subject to the Tender Offer regulation (Article 27-2(1)(v) of the FIEA). However, in order to avoid overregulation, a Tender Offer is obligated when, during a period when a person conducts a Tender Offer, another person who holds more than one-third of the outstanding total also makes rapid purchases (Article 27-2(1)(v) of the FIEA).
2. Specifically, the Tender Offer regulation applies when, during a period when a person is already conducting a Tender Offer, another person who holds more than one-third of the outstanding total makes Purchases, etc. of more than 5% at or outside of Financial Instruments Exchange Markets (Article 7(5) and (6) of the FIEA Enforcement Order; Article 4-2(3) of the Cabinet Office Ordinance on Disclosure Required for Tender Offer for Share Certificates, etc. by Person Other than Issuer [hereinafter referred to as the “Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer”])).

Q6. How does the FIEA provide for cases that are excluded from application of the Tender Offer regulation?

A1. In light of the purpose of the Tender Offer regulation, the FIEA excludes the following transactions from application of the Tender Offer regulation as those that are not likely to impair the protection of investors even if they were not conducted by means of a Tender Offer or those that have little need to be conducted by means of a Tender Offer:

- (i) the Purchase, etc. of Share Certificates, etc. conducted as an exercise of a share option, etc. (the proviso to Article 27-2(1) of the FIEA; Article 6-2(1)(i) through (iii), (xi) and (xii) of the FIEA Enforcement Order);
- (ii) the Purchase, etc. of Share Certificates, etc. from Specific Interested Parties (the proviso to Article 27-2(1) of the FIEA; Article 3(1) of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer);
- (iii) the Purchase, etc. of Share Certificates, etc. within a corporate group (Article 6-2(1)(v) and (vi) of the FIEA Enforcement Order; Article 2-3 and Article 2-4 of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer); and
- (iv) the Purchase, etc. of Share Certificates, etc. from an extremely small number of persons where the total number of holders of Share Certificates, etc. is less than 25 and all of the holders have given their consent to not using the means of a Tender Offer, among those where the Share Certificates, etc. Holding Rate after the Purchase, etc. exceeds one-third of the outstanding total (Article 6-2(1)(vii) of the FIEA Enforcement Order; Article 2-5(1) of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer).

2. In addition to the above, transactions including (i) the Purchase, etc. pertaining to Share Certificates, etc. issued by a Subsidiary Company in which the company holds more than 50% of the voting rights and (ii) Specified Purchase, etc. made through the exercise of the security interest are also excluded from application of the Tender Offer regulation (Article 6-2(1)(iv), (viii) through (x) and (xiii) through (xv) of the FIEA Enforcement Order; Article 2-6 of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer).

Q7. How does the FIEA provide for the disclosure in a Tender Offer Notification?

A1. A Tender Offeror must submit a Tender Offer Notification to the Prime Minister on the day of making a Public Notice for Commencing Tender Offer (Article 27-3(2) of the FIEA).

2. A Tender Offer Notification must contain information including the outline of the Tender Offer, the situation of the Tender Offeror, the status of the holding and trading of Share Certificates, etc. by the Tender Offeror and its Specific Interested Parties, transactions between the Tender Offeror and the Subject Company and the situation of the Subject Company (Form 2 of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer).

3. In addition, the following documents need to be attached to the Tender Offer Notification (Article

13(1) of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer):

- (i) the articles of incorporation or a document equivalent thereto;
- (ii) when the Tender Offeror is a juridical person, etc. other than the company that needs to submit the Annual Securities Report, a document that sufficiently establishes that the juridical person, etc. has been formed;
- (iii) when the Tender Offeror is an individual, the residence certificate or a document in substitution thereof;
- (iv) when the Tender Offeror is a Non-Resident, a document proving the granting of the authority to represent said person for all acts concerning submission of documents pertaining to the Tender Offer;
- (v) a copy of the contract concluded with a securities company or Bank, etc. with regard to the custody of Share Certificates, etc., payment for the Purchase, etc. and other affairs;
- (vi) when there is a person who makes a Purchase, etc. of Share Certificates, etc. by means of a Tender Offer as an agent for the Tender Offeror, a copy of the contract concluded with regard to the agency;
- (vii) a document that sufficiently indicates the balance of the Tender Offeror's deposit in a Bank, etc. or any other existence of funds necessary for the Tender Offer;
- (viii) when there is an evaluation report, etc. by a third party which has been used as a reference material in calculating the Tender Offer Price, a copy thereof (limited to the case where the Tender Offeror is an officer of the Subject Company, a person conducting the Tender Offer based on a request of the officer, a company for which the Subject Company is a Subsidiary Company, etc.);
- (ix) when the acquisition of Share Certificates, etc. requires the permission, etc. of an administrative agency based on another law or regulation, a document that sufficiently establishes that the said permission, etc. has been obtained (limited to the case where the permission, etc. has already been obtained); and
- (x) a document stating the contents of the Public Notice for Commencing Tender Offer.

<p><b>Q8. In what kind of cases is it possible to change the Terms of Purchase, etc. for a Tender Offer?</b></p>
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A1. With regard to the Terms of Purchase, etc. for a Tender Offer, the FIEA prohibits changes in a way that will be disadvantageous for the accepting shareholders, such as lowering of the Tender Offer Price (Article 27-6(1) of the FIEA). However, if the lowering of the Tender Offer Price is not allowed when the share price is diluted as a result of the Subject Company conducting a share split or allotment of shares or share options without contribution as so-called anti-takeover measures, it could cause unexpected damage to the Tender Offeror. Therefore, the FIEA permits the lowering of the Tender Offer Price corresponding to the diluted amount (Article 27-6(1)(i) of the FIEA; Article 13(1) of the FIEA Enforcement Order; Article 19(1) of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer).

2. The lowering of the Tender Offer Price mentioned above is permitted only in cases where the Public Notice for Commencing Tender Offer and the Tender Offer Notification state as one of the Terms of Purchase, etc. that the price for Purchase, etc. may be lowered if the Subject Company conducts a split of Shares, etc. or allotment of shares or share options without contribution during the Tender Offer Period (Article 27-6(1)(i) of the FIEA).

**Q9. In what kind of cases is it possible to withdraw a Tender Offer?**

- A1. The FIEA permits withdrawal of a Tender Offer in the case where any important change occurs in the business or property of the Subject Company or its Subsidiary (Article 27-11(1) of the FIEA).
2. In addition, the report of the Working Group on the Tender Offer Regulation, etc. of the First Subcommittee of the Financial System Council states that in certain cases it is appropriate to allow withdrawal for a Subject Company that has introduced so-called anti-takeover measures. Based on this, withdrawal is permitted also on specific grounds including the following: (i) when having made a decision to conduct a split of Shares, etc. or allotment of shares or share options without contribution (Article 14(1)(i)(l) and (m) of the FIEA Enforcement Order); (ii) when having made a decision to issue new shares or share options, etc. (Article 14(1)(i)(n) of the FIEA Enforcement Order); (iii) when having made a decision to dispose of or transfer important property (Article 14(1)(i)(q) of the FIEA Enforcement Order); or (iv) when having decided to borrow a large amount of money (Article 14(1)(i)(r) of the FIEA Enforcement Order).
3. Withdrawal is also permitted in the case where so-called anti-takeover measures have been taken and the Subject Company has already made and publicly announced a decision that it may conduct issuance of new shares or any other act that would reduce the Share Certificates, etc. Holding Rate of the Tender Offeror by 10% or more after the Tender Offer, and has publicly announced that it will maintain such anti-takeover measures (Article 14(1)(ii)(a) of the FIEA Enforcement Order; Article 26(2) of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer). Since so-called anti-takeover measures would not be limited to such measure that dilutes the Share Certificates, etc. Holding Rate of the Tender Offeror, but would also include a measure to issue class shares with veto rights, etc. in advance, withdrawal is also permitted when the Subject Company makes a decision to maintain class shares with veto rights, etc. without changing their contents (Article 14(1)(ii)(b) of the FIEA Enforcement Order).

**Q10. Why is the Subject Company of a Tender Offer obligated to submit a Subject Company's Position Statement?**

- A1. The position which the Subject Company takes toward the Tender Offer is considered to be important information for shareholders and investors to make accurate Investment Decisions. In particular, in the case of a hostile Tender Offer, it would be possible to enhance the accuracy of the Investment Decisions of shareholders and investors by making the arguments and counterarguments of the Tender Offeror and the Subject Company visible to them. From such a

viewpoint, the Subject Company is obligated to state its position (Article 27-10(1) of the FIEA).

2. The Subject Company must submit a Subject Company's Position Statement within ten business days from the day of the Public Notice for Commencing Tender Offer (Article 27-10(1) of the FIEA; Article 13-2(1) of the FIEA Enforcement Order).
3. A Subject Company's Position Statement is made available for public inspection (Article 27-14 of the FIEA). A person who submits a Subject Company's Position Statement containing a false statement is subject to the punishment of imprisonment with work for not more than five years, etc. (Article 197-2(vi) and Article 207(1)(ii) of the FIEA), and a person who fails to submit a Subject Company's Position Statement is subject to the punishment of imprisonment with work for not more than one year, etc. (Article 200(x) and Article 207(1)(v) of the FIEA).

Q11. What kind of matters should be included in the statement of the position of the Subject Company of a Tender Offer?
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- A1. Subject Company's position and the reason therefor, and (ii) if the company has introduced or plans to introduce so-called anti-takeover measures, the contents thereof (Article 27-10(1) of the FIEA; Article 25(1) of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer). In addition, a Subject Company is required to particularly state the process of making the decision on supporting or opposing the Tender Offer, as the reason for the company's position (Article 25(2) and Points to Note in Preparing Statements (b) of Form 4 of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer).
2. It is also permissible for a Subject Company to withhold a statement of its position while indicating the reason therefor, depending on the situation (Points to Note in Preparing Statements (a) of Form 4 of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer).

Q12. Why is the Subject Company of a Tender Offer given an opportunity to ask the Tender Offeror questions?
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- A. By giving the Subject Company of a Tender Offer an opportunity to ask the Tender Offeror questions, the differences in the position between the Tender Offeror and the Subject Company are considered to become clearer, and this is considered to be useful information for investors and shareholders to make Investment Decisions. Due to such an idea, the Subject Company is given an opportunity to ask the Tender Offeror questions in the Subject Company's Position Statement (Article 27-10(2)(i) of the FIEA).

Q13. What is the arrangement for the Subject Company of a Tender Offer to ask the Tender Offeror questions, and how many opportunities to ask questions are available?
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- A. Given that the process of a Tender Offer is an interaction with regard to the control of a listed company, etc., both the Tender Offeror and the Subject Company have inherent incentives to provide persuasive information to investors and shareholders. Also, it is a common practice for

Subject Companies to ask Tender Offerors questions. In light of the facts above, just one opportunity to ask questions is legally provided for the Subject Company, and this matter is in principle left to the voluntary initiative of the parties concerned as a matter of market practice.

**Q14. How should a Tender Offeror respond when it receives questions from the Subject Company?**

- A1. When a Tender Offeror receives questions from the Subject Company in the Subject Company's Position Statement, it must submit a "Tender Offeror's Answer" containing its answers to those questions within five business days from the day of receipt of a copy of the Subject Company's Position Statement (Article 27-10(11) of the FIEA; Article 13-2(2) of the FIEA Enforcement Order). However, because an answer from the Tender Offeror becomes subject to evaluation by investors and shareholders, including whether or not the Tender Offeror gives an answer, the Tender Offeror may also choose not to give an answer as long as it indicates the reason therefor (Article 13-2(2) of the FIEA Enforcement Order; Article 25(3) of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer).
2. A Tender Offeror's Answer is made available for public inspection (Article 27-14 of the FIEA). A person who submits a Tender Offeror's Answer containing a false statement is subject to the punishment of imprisonment with work for not more than five years, etc. (Article 197-2(vi) and Article 207(1)(ii) of the FIEA), and a person who fails to submit a Tender Offeror's Answer is subject to the punishment of imprisonment with work for not more than one year, etc. (Article 200(x) and Article 207(1)(v) of the FIEA).

**Q15. How long is the Tender Offer Period under the FIEA?**

- A1. The FIEA provides that the Tender Offer Period should be decided by the Tender Offeror as a period between 20 business days to 60 business days (Article 27-2(2) of the FIEA; Article 8(1) of the FIEA Enforcement Order).
2. The Tender Offer Period is prescribed on a business day basis because if a Tender Offer is conducted during a period when there are consecutive holidays, the management of the Subject Company may have little time to make a counterproposal, etc., and it may impede investors and shareholders from acquiring sufficient information or securing sufficient time to make careful consideration.

**Q16. Why is it that there is an arrangement to allow the Subject Company of a Tender Offer to request extension of the Tender Offer Period?**

- A1. If a Tender Offeror sets a short Tender Offer Period, and particularly if the management of the Subject Company is against the Tender Offer with such a short Tender Offer Period, it may be impossible to secure sufficient time for the management to appropriately present a counterproposal, etc. to investors and shareholders and for investors and shareholders to appropriately make careful consideration and a decision based on it.

2. If the Tender Offer Period has been set shorter than a certain period by the Tender Offeror, and the Subject Company states a position in opposition, etc. to the Tender Offer, the Subject Company may request extension of the Tender Offer Period in the Subject Company's Position Statement since a certain period of time will be required to present a counterproposal, etc. to investors and shareholders (Article 27-10(2)(ii) of the FIEA).

Q17. What will happen to the Tender Offer Period if the Subject Company of a Tender Offer requests extension of the Tender Offer Period?

- A1. If the Tender Offer Period initially set by the Tender Offeror is short (shorter than 30 business days), and the Subject Company requests extension of the Tender Offer Period in the Subject Company's Position Statement, the Tender Offer Period will be extended to a certain period (30 business days) (Article 27-10(3) of the FIEA).
2. The specific number of days for which the Tender Offer Period is extended is 30 business days, which is half of the maximum Tender Offer Period of 60 business days, given that the period is for the Subject Company to appropriately present a counterproposal, etc. to investors and shareholders in the case of a hostile Tender Offer (Article 27-10(3) of the FIEA; Article 9-3(6) of the FIEA Enforcement Order).
3. If the Subject Company requests extension of the Tender Offer Period, the period is uniformly extended to 30 business days, and the Subject Company cannot choose the period to be extended.
4. From the viewpoint of informing shareholders and investors of the possibility for the requesting of extension and of the correct Tender Offer Period, the FIEA provides for the following procedures:
- (i) if the Tender Offer Period is shorter than 30 business days, the Tender Offeror must clearly indicate that the period may be extended in the Public Notice for Commencing Tender Offer (Article 27-3(1) of the FIEA); and
  - (ii) if the Subject Company states that it requests extension of the period in the Subject Company's Position Statement, it must make a Public Notice of Request for Period Extension by the day following the 10th business day from the day of the Public Notice for Commencing Tender Offer (Article 27-10(4) of the FIEA; Article 9-3 of the FIEA Enforcement Order; Article 25-2 of the Cabinet Office Ordinance on Disclosure for Tender Offer by Non-Issuer).

Q18. In what kind of cases is the Tender Offeror obligated to purchase all tendered shares?

- A1. If the total number of the Share Certificates, etc. Offered to Sell exceeds the Number of Share Certificates, etc. Planned to be Purchased, the Tender Offeror is allowed to refrain from making Purchase, etc. of all or part of the portion in excess based on the method of proportional distribution (allowing of partial purchase).
2. Meanwhile, if the Share Certificates, etc. Holding Rate after a Tender Offer exceeds a certain proportion, it could lead to a possibility of delisting, etc., and minor shareholders who have remaining shares at hand will be put into a considerably unstable position.

3. Based on such an idea, if the Share Certificates, etc. Holding Rate of the Tender Offeror after the Tender Offer combined with that of its Specific Interested Parties totals two-thirds or more of the outstanding total, the Tender Offeror is not allowed to make a partial purchase, and must conduct settlement procedures for all of the Share Certificates, etc. Offered to Sell (obligation to purchase all tendered shares) (Article 27-13(4) of the FIEA; Article 14-2-2 of the FIEA Enforcement Order).

## Section 5 Large shareholding reporting system

### Q1. What is the large shareholding reporting system?

- A1. The large shareholding reporting system requires a person who has become a Large Shareholder of Share Certificates, etc. issued by a Listed Company, etc. to disclose the status of shareholding by submitting a Large Shareholding Report within a prescribed period. The purpose of this system is to enhance the fairness and transparency of the market and protect investors by promptly providing investors with information on large volume holding of Listed Share Certificates, etc., which is important investment information from the viewpoint of the influence on business management, etc. Large Shareholder as a result of the holder's Holding Ratio of Share Certificates, etc. exceeding 5% must submit a Large Shareholding Report within five business days from that day, in principle (Article 27-23(1) of the FIEA). If, the Holding Ratio of Share Certificates, etc. increases or decreases by 1% or more after submitting a Large Shareholding Report, the holder must submit a Change Report within five business days from that day, in principle (Article 27-25(1) of the FIEA).
3. Multiple holders of Share Certificates, etc. who agree to jointly conduct acquisition or disposal of Share Certificates, etc. and exercise of shareholder's rights such as voting rights are treated as Joint Holders. When calculating the Holding Ratio of Share Certificates, etc. of a holder, the Number of Share Certificates, etc. Held by the Joint Holders must be included in the calculation (Article 27-23(4) and (5) of the FIEA). If holders are husband and wife, a parent company and a subsidiary, or in a similar relationship where they are highly likely to agree on joint holding, they are deemed to be Joint Holders (Article 27-23(6) of the FIEA).
4. A Large Shareholding Report is made available for public inspection for five years from the day of submission at the competent local finance (branch) bureau or the Okinawa General Bureau, and the Financial Instruments Exchange where the Share Certificates, etc. are listed or the Authorized Financial Instruments Firms Association where the Share Certificates, etc. are registered for over-the-counter trading (Article 27-28(1) of the FIEA). It can also be viewed on the Internet through the electronic disclosure system (EDINET: Electronic Disclosure for Investors' NETwork).

### Q2. What is the exceptional reporting system?

- A1. Under the large shareholding reporting system, a holder who newly holds a large volume of Share Certificates, etc. or whose holding status has changed in a certain manner must submit a Large Shareholding Report or a Change Report within five business days, in principle.
2. However, for institutional investors, etc. that repeatedly and continuously sell and purchase Share Certificates, etc. in their daily operations, a requirement to disclose detailed information upon each transaction would be an excessive administrative burden. Therefore, the rules on the frequency and the period for submitting Large Shareholding Reports and Change Reports are relaxed to a certain extent for such investors, while taking into account that such measure would not impede the transparency and fairness of Securities transactions (exceptional reporting system).

3. The Share Certificates, etc. subject to the exceptional reporting system are those held by the following (Article 27-26(1) of the FIEA; Article 11 and Article 14 of the Cabinet Office Ordinance on Disclosure of the Status of Large Volume Holding of Share Certificates, etc. [hereinafter referred to as the “Cabinet Office Ordinance on Large Volume Holding”]):

- (i) securities companies;
- (ii) those that conduct Investment Management Business;
- (iii) banks;
- (iv) trust companies;
- (v) insurance companies;
- (vi) Norinchukin Bank;
- (vii) Shoko Chukin Bank;
- (viii) those that conduct securities business, Investment Management Business, banking business, trust business, or insurance business in a foreign state under the laws and regulations of a foreign state;
- (ix) Banks' Shareholdings Purchase Corporation;
- (x) those other than (i) through (ix) above who have any person set forth in (i) through (ix) above as a Joint Holder;
- (xi) the national government or a local government; and
- (xii) those other than the national government or a local government who have either the national government or a local government as a Joint Holder.

However, the exceptional reporting system does not apply in the following cases:

- (1) if any person set forth in (i) through (ix) holds Share Certificates, etc. for conducting an act of effecting material changes in or having a material effect on the business activities of the Issuer of said Share Certificates, etc. (Act of Making Important Suggestion, etc.; see Q 132) (Article 27-26(1) of the FIEA); or
- (2) if any person set forth in (i) through (ix) has a Joint Holder other than those set forth in (i) through (ix) whose Holding Ratio of Share Certificates, etc. exceeds 1% (Article 13(i) of the Cabinet Office Ordinance on Large Volume Holding).

<b>Q3. What are the specific time limits and frequency of exceptional reporting?</b>
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A. The time limit and frequency of exceptional reporting are within five business days from the Reference Date that is set roughly every two weeks (Article 27-26(3) of the FIEA). The specific method of setting the Reference Date is that the Holder of Share Certificates, etc. Subject to Special Provisions chooses the combination of either (i) the second and fourth Mondays of every month (in a month that has a fifth Monday, the second, fourth, and fifth Mondays) or (ii) the 15th day and the last day of every month, and notifies the Prime Minister thereof (Article 27-26(3) of the FIEA; Article 14-8-2(2) of the FIEA Enforcement Order; Article 18(1) and Form 4 of the Cabinet Office Ordinance on Large Volume Holding).

Q4. Why does the FIEA provide that exceptional reporting is not applicable to the case where Share Certificates, etc. are held for conducting an act of effecting material changes in or having a material effect on the business activities of the Issuer of said Share Certificates, etc. as specified by Cabinet Order (Act of Making Important Suggestion, etc.)?

A1. For institutional investors, etc. that repeatedly and continuously sell and purchase Share Certificates, etc. in their daily operations, a requirement to disclose detailed information upon each transaction would be an excessive administrative burden. Therefore, they are subject to exceptional reporting with somewhat relaxed rules on the frequency and the period for submitting reports.

2. However, exceptional reporting is not applicable when Share Certificates, etc. are held for conducting an act of effecting material changes in or having a material effect on the business activities of the Issuer of said Share Certificates, etc. (Act of Making Important Suggestion, etc.), from the viewpoint of preventing use of the system in a manner that distorts the purpose of the system (Article 27-26(1) of the FIEA).

3. The specific act that constitutes an Act of Making Important Suggestion, etc. is to suggest any of the following matters pertaining to the Issuer or its Subsidiary Company to its shareholders meeting or officers (Article 27-26(1) of the FIEA; Article 14-8-2(1) of the FIEA Enforcement Order; Article 16 of the Cabinet Office Ordinance on Large Volume Holding):

- (i) disposal or acceptance of assignment of important properties;
- (ii) borrowing in a significant amount;
- (iii) selection or removal of a representative director;
- (iv) important changes in the composition of officers;
- (v) appointment or dismissal of a manager or any other important employee;
- (vi) establishment, changes or abolition of a branch office or any other important organization;
- (vii) share exchange, share transfer, or company split or merger;
- (viii) assignment, acceptance, suspension, or abolition of the business in whole or in part;
- (ix) important changes in the policy concerning dividend distribution;
- (x) important changes in the policy concerning the increase or reduction of the amount of stated capital;
- (xi) delisting from a Financial Instruments Exchange or rescission of registration with an over-the-counter market;
- (xii) listing on a Financial Instruments Exchange or registration with an over-the-counter market;
- (xiii) important changes concerning the capital policy (excluding (x) above);
- (xiv) dissolution (excluding dissolution as a result of a merger); or
- (xv) the filing of a petition for commencement of bankruptcy proceedings, commencement of rehabilitation proceedings, or commencement of reorganization proceedings.

Large Shareholding Report (Article 27-23(1) of the FIEA; Article 2 and Points to Note in Preparing Statements of Form 1 of the Cabinet Office Ordinance on Large Volume Holding), and

state the contents of the Act of Making Important Suggestion, etc. as specifically as possible (Points to Note in Preparing Statements of Form 1 of the Cabinet Office Ordinance on Large Volume Holding).

Q5. What is the treatment for the case of conducting transactions that result in the Holding Ratio of Share Certificates, etc. of an institutional investor, etc. that uses the exceptional reporting system falling below 10% from above the 10% level?

- A1. It had been pointed out that under the previous system, when an institutional investor that held over 10% of the outstanding total conducted transactions that make the holding ratio fall below 10% in a short term, such information would be important for other investors and shareholders in making Investment Decisions, but it took time until such information was disclosed due to the application of the exceptional reporting system.
2. Due to such criticism, the current system does not apply exceptional reporting for a Change Report in such a case, and obligates the institutional investor, etc. to submit a Change Report through general reporting within five business days, in order to secure increased transparency for other investors (Article 27-26(2)(iii) of the FIEA; Article 8 and Article 12 of the Cabinet Office Ordinance on Large Volume Holding).

Q6. What is the treatment for the case where the Share Certificates, etc. held by a holder and a Joint Holder overlap in calculating the Holding Ratio of Share Certificates, etc.?

- A1. In calculating the Holding Ratio of Share Certificates, etc., any overlap in the Number of Share Certificates, etc. Held between a holder and a Joint Holder is to be deducted (Article 27-23(4) of the FIEA).
2. Specifically, Share Certificates, etc. for which there exists any of the following rights between the holder and the Joint Holder (including between the Joint Holder and another Joint Holder) are to be deducted from the Number of Share Certificates, etc. Held of the person holding such right (Article 27-23(4) of the FIEA; Article 14-6-2 of the FIEA Enforcement Order):
- (i) a right to request delivery of Share Certificates, etc. under sales and purchase or any other contract;
  - (ii) a right to exercise the voting right as a shareholder or investor of the Issuer of the Share Certificates, etc. or a right to give instruction with regard to the exercise of such voting right under a money trust contract or any other contract or the provisions of laws;
  - (iii) a right required for making investments in Share Certificates, etc. based on a Discretionary Investment Contract or any other contracts or the provisions of laws;
  - (iv) a right to complete the sales and purchase of Share Certificates, etc. and to acquire the position as a buyer under the pre-contract of the sales and purchase of Share Certificates, etc. exercisable by one party; and
  - (v) a right where the person who has exercised the option pertaining to sales and purchase of Share

Certificates, etc. acquires the position as a buyer through such exercise of the option (a call option).

Q7. Are investment securities issued by investment corporations subject to the large shareholding reporting system?

- A1. Investment securities issued by an investment corporation are securities for which the investor has voting rights (Article 2(14) through (16) and Article 77(2)(iii) of the Act on Investment Trusts and Investment Corporations), which could lead to acquisition of the controlling interest in the investment corporation.
2. Therefore, Securities subject to the large shareholding reporting system include Investment Securities, etc. (Article 27-23(1) of the FIEA; Article 14-4(1)(iii) of the FIEA Enforcement Order). Accordingly, holders of investment securities issued by investment corporations are also obligated to submit Large Shareholding Reports.

Q8. Must the disclosure documents under the large shareholding reporting system be submitted through the electronic disclosure system (EDINET)?

- A1. The large shareholding reporting system obligates submission of Large Shareholding Reports, Change Reports, and Amendment Reports through the electronic disclosure system (EDINET: Electronic Disclosure for Investors' NETwork) (Article 27-30-2 and Article 27-30-3(1) of the FIEA).
2. Reports submitted through EDINET are made available for public inspection on the Internet (Article 27-30-7 of the FIEA; Article 14-12 of the FIEA Enforcement Order).

## Section 6 Financial Instruments Business Operator, etc.

### Outline

Q1. What kind of operator is a Financial Instruments Business Operator?
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- A1. A Financial Instruments Business Operator is a person registered by the Prime Minister under Article 29 of the FIEA with regard to conducting Financial Instruments Business (Article 2(9) of the FIEA).
2. Financial Instruments Business (Article 2(8) of the FIEA) includes securities business, financial futures trading, mortgage securities business, commodity investment business, beneficiary right sales, Investment Advisory Business, Discretionary Investment Management Business, investment trust management business, and investment corporation asset management business under the former Securities and Exchange Act and Act on Foreign Securities Brokers, as well as an act of an Issuer soliciting applications for acquisition of Securities newly issued by the Issuer (self-offering), an agency or intermediary service for conclusion of Investment Advisory Contracts or Discretionary Investment Contracts, an act of forming a collective investment scheme, etc. and mainly investing in Securities or rights pertaining to Derivative Transactions (self-management), an act of receiving deposit of money or Securities from customers with regard to Securities transactions, etc., and an act of transferring bonds, etc. in response to opening of an account for transfer of bonds, etc. Financial Instruments Business Operators are those that have been registered to conduct these businesses.
  3. The FIEA provides for the following as the Categories of Businesses of Financial Instruments Business Operators: Type I Financial Instruments Business (Article 28(1) of the FIEA); Type II Financial Instruments Business (Article 28(2) of the FIEA); Investment Advisory and Agency Business (Article 28(3) of the FIEA); and Investment Management Business (Article 28(4) of the FIEA). A Financial Instruments Business Operator needs to be registered in order to conduct any of these businesses (Article 29 of the FIEA). Any business that is categorized as a Financial Instruments Business can be conducted with single registration. Accordingly, it would be sufficient for a business operator to have obtained single registration as a Financial Instruments Business Operator to conduct Type I Financial Instruments Business or any other categories of Financial Instruments Business listed above, although there are differences in the requirements for refusing registration. However, authorization needs to be obtained to conduct PTS (Proprietary Trading System) business (Article 30(1) of the FIEA).
  4. As for Investment Management Business and Securities-Related Business (Article 28(8) of the FIEA) conducted by financial institutions, they are not categorized as Financial Instruments Business (the principal sentence of Article 2(8) of the FIEA), so financial institutions cannot obtain registration as a Financial Instruments Business Operator for conducting Investment Management Business and Securities-Related Business. Meanwhile, the FIEA does not expressly deny

obtainment of registration as a Financial Instruments Business Operator for financial institutions to conduct businesses other than Investment Management Business and Securities-Related Business, such as Investment Advisory Business. However, since financial institutions that have obtained registration as Registered Financial Institutions (Article 2(11) of the FIEA) are able to conduct certain operations of Securities-Related Business and conduct businesses other than Investment Management Business and Securities-Related Business, such as Investment Advisory Business, financial institutions are generally expected to be registered not as Financial Instruments Business Operators, but as Registered Financial Institutions (Article 33-2 of the FIEA).

<b>Q2. What is Type I Financial Instruments Business?</b>
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A1. Type I Financial Instruments Business is conducting any of the following acts of Financial Instruments Business on a regular basis (Article 28(1) of the FIEA):

- (i) sales and purchase/Market Transactions of Derivatives/Foreign Market Derivatives Transactions, intermediary/brokerage/agency services for these transactions, intermediary/brokerage/agency services for entrustment of these transactions, Brokerage for Clearing of Securities, etc., Secondary Distribution, or dealing in Public Offering/Secondary Distribution/Private Placement with regard to Paragraph (1) Securities;
- (ii) intermediary/brokerage/agency services with regard to Commodity-Related Market Transactions of Derivatives, or Brokerage for Clearing of Securities, etc. with regard to Over-the-Counter Transactions of Derivatives;
- (iii) Over-the-Counter Transactions of Derivatives;
- (iv) Underwriting of Securities;
- (v) PTS (proprietary trading system) business; or
- (vi) Securities, etc. Management Business.

2. Financial Instruments Business Operators that conduct Type I Financial Instruments Business are subject to strict property regulation including Capital Adequacy Ratio (Article 29-4(1)(vi)(a) and Article 46-6(2) of the FIEA), as well as stock company requirement, major shareholder regulation, and subsidiary business regulation (Article 29-4(1)(iv) through (v), Articles 32 through 32-4, and Article 35 of the FIEA).

3. Since Financial Instruments Business Operators that are registered to conduct Type I Financial Instruments Business satisfy such strict property regulation, etc., they also basically satisfy the property regulation, etc. for conducting Financial Instruments Business other than Type I Financial Instruments Business (Type II Financial Instruments Business, Investment Advisory and Agency Business, and Investment Management Business). However, in order to change the Category of Businesses (Article 29-2(1)(v) of the FIEA), registration of change is required (Article 31(4) of the FIEA; Article 22 and Appended Form 1 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

**Q3. What are businesses that can only be conducted by Financial Instruments Business Operators conducting Type I Financial Instruments Business?**

A. Businesses categorized as Type I Financial Instruments Business (Article 28(1) of the FIEA) can only be conducted by Financial Instruments Business Operators that are registered to conduct Type I Financial Instruments Business due to the following reasons, and they cannot be conducted by Financial Instruments Business Operators that are registered to only conduct Financial Instruments Business other than Type I Financial Instruments Business (Type II Financial Instruments Business, Investment Advisory and Agency Business, or Investment Management Business):

- (i) sales and purchase, etc. of high-liquidity Securities are expected to involve a large number of persons in the transactions;
- (ii) Over-the-Counter Transactions of Derivatives, etc. are recognized to involve particularly high expertise and risks;
- (iii) Underwriting of Securities is recognized to involve high expertise and underwriting risks;
- (iv) PTS (Proprietary Trading System), as in the case of Financial Instruments Exchanges, expect participation of a large number of persons due to its nature, and particularly require smooth and stable business operations, while Securities handled in its system are expected to have high liquidity; and
- (v) Securities, etc. Management Business involves the risk of causing the entitled persons to lose their rights unless ensuring the financial soundness of those receiving a deposit of money or Securities from customers in relation to Financial Instruments Business and of Account Management Institutions.

**Q4. What is Type II Financial Instruments Business?**

A1. Type II Financial Instruments Business is conducting any of the following acts of Financial Instruments Business on a regular basis (Article 28(2) of the FIEA):

- (i) self-offering or Private Placement of Securities;
- (ii) sales and purchase/Market Transactions of Derivatives/Foreign Market Derivatives Transactions, intermediary/brokerage/agency services for these transactions, intermediary/brokerage/agency services for entrustment of these transactions, Brokerage for Clearing of Securities, etc., Secondary Distribution, or dealing in Public Offering/Secondary Distribution/Private Placement with regard to Paragraph (2) Securities;
- (iii) Market Transactions of Derivatives or Foreign Market Derivatives Transactions unrelated to Securities, intermediary/brokerage/agency services for these transactions, intermediary/brokerage/agency services for entrustment of these transactions, or Brokerage for Clearing of Securities, etc. with regard to these transactions; or
- (iv) the acts specified by Cabinet Order as those categorized as Financial Instruments Business.

The acts designated as those set forth in (iv) above are the purchase without the purpose of resale of Beneficiary Securities of Investment Trusts Managed under the Instructions of the Settlor and

Beneficiary Securities of foreign investment trusts (Article 1-12 of the FIEA Enforcement Order).

2. The self-offering set forth in (i) above has been newly prescribed under the FIEA as an act categorized as Financial Instruments Business. Since this is a business where an Issuer solicits Offers to Acquire Securities newly issued by the Issuer, which involves no need to protect investors by imposing strict property requirements as those for an intermediary, the business is categorized as Type II Financial Instruments Business instead of Type I Financial Instruments Business.
3. With regard to registration as a Financial Instruments Business Operator that only conducts Type II Financial Instruments Business, the requirements are more relaxed compared to those for the registration to conduct Type I Financial Instruments Business or Investment Management Business. For example, individuals are able to be registered as such Financial Instruments Business Operators, and the only property regulation applied is the minimum amount of stated capital regulation (the deposit for operation regulation in the case of individuals) (Article 29-4(1)(iv) and Article 31-2 of the FIEA).

Q5. What is Investment Advisory and Agency Business?
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- A1. Investment Advisory and Agency Business is conducting any of the following acts of Financial Instruments Business on a regular basis (Article 28(3) of the FIEA):
  - (i) an act of concluding an Investment Advisory Contract, and giving advice on Investment Decisions that are based on analysis of values, etc. of Securities or values, etc. of Financial Instruments under such Investment Advisory Contract (i.e. Investment Advisory Business) (Article 2(8)(xi) of the FIEA); or
  - (ii) an agency or intermediary service for conclusion of Investment Advisory Contracts or Discretionary Investment Contracts (Article 2(8)(xiii) of the FIEA).
2. As for the scope of Investment Advisory Business (Article 28(6) of the FIEA), with regard to Securities and Transactions of Securities-Related Derivatives, an act of merely giving advice on the values, etc. of Securities (the value of Securities, amount receivable for Securities Related Options, or movement of Securities Indicators) is categorized as such business. However, with regard to Derivative Transactions that are unrelated to Securities, a mere act of giving advice on the value of a Financial Instrument, which is an underlying asset, or movement of a Financial Indicator, which is a reference indicator, is not categorized as Investment Advisory Business; an act is categorized as such only when advice on Investment Decisions is given. For example, an act of only giving advice on Japan's average temperature this summer is not categorized as Investment Advisory Business.
3. With regard to registration as a Financial Instruments Business Operator that only conducts Investment Advisory and Agency Business, for example, individuals are able to be registered as such Financial Instruments Business Operators. Also, no property regulation is applied (except for the deposit for operation regulation [Article 31-2 of the FIEA]), so anyone who satisfies the requirements common to all Financial Instruments Business can be registered (Article 29-4(1)(i)

through (iii) of the FIEA).

Q6. What is Investment Management Business?
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A1. Investment Management Business is conducting any of the following acts of Financial Instruments Business on a regular basis (Article 28(4) of the FIEA):

- (i) an act of concluding an entrustment contract for the asset management with a registered investment corporation, and the management money or other properties as an investment in Securities or in rights pertaining to Derivative Transactions under Investment Decisions based on an analysis of values, etc. of Financial Instruments (the value of Financial Instruments, amount receivable for Options, or movement of Financial Indicators) (Article 2(8)(xii)(a) of the FIEA) (the conventional Investment Corporation Asset Management Business);
- (ii) an act of concluding a Discretionary Investment Contract, and the management money or other properties as an investment in Securities or in rights pertaining to Derivative Transactions under Investment Decisions based on an analysis of values, etc. of Financial Instruments (Article 2(8)(xii)(b) of the FIEA) (the conventional Business Pertaining to Discretionary Investment Contract);
- (iii) an act of the management money or other properties contributed by right holders of Beneficiary Securities of Investment Trusts as an investment in Securities or rights pertaining to Derivative Transactions under Investment Decisions based on analysis of values, etc. of Financial Instruments (Article 2(8)(xiv) of the FIEA; Article 1-11 of the FIEA Enforcement Order) (the conventional Investment Trust Management Business); or
- (iv) an act of the management money or other properties invested or contributed by right holders of trust beneficial interests or interests in collective investment schemes as an investment in Securities or in rights pertaining to Derivative Transactions under Investment Decisions based on an analysis of values, etc. of Financial Instruments (Article 2(8)(xv) of the FIEA) (self-management of funds).

2. In this manner, the FIEA provides for the scope of Investment Management Business as including not only the conventional business pertaining to Discretionary Investment Contract, investment corporation asset management business, and investment trust management business, but also the business of forming a collective investment scheme, etc. and mainly investing in Securities or rights pertaining to Derivative Transactions (self-management).

3. Those registered as Financial Instruments Business Operators that conduct Investment Management Business are subject to stock company requirement, subsidiary business regulation, and major shareholder regulation (Article 29-4(1)(v)(a) and (c) through (f), Articles 32 through 32-4, and Article 35 of the FIEA). They are also subject to the property regulation imposed on those that conduct Type I Financial Instruments Business, except for the Capital Adequacy Ratio (Article 29-4(1)(iv) and (v)(b) of the FIEA), so they will basically satisfy the property requirements, etc. for conducting Type II Financial Instruments Business and Investment Advisory and Agency Business.

However, in order to change the Category of Businesses (Article 29-2(1)(v) of the FIEA), a registration of change is required (Article 31(4) of the FIEA; Article 22 and Appended Form 1 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

4. Meanwhile, an act of a financial institution conducting any of the acts categorized as Investment Management Business on a regular basis does not fall under the definition of Financial Instruments Business (the principal sentence of Article 2(8) of the FIEA), but the FIEA clearly provides that such an act falls under the definition of Investment Management Business (the principal sentence of Article 28(4) of the FIEA).

Q7. How is the distinction between Discretionary Investment Management Business and Investment Advisory Business determined?
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- A1. Between Investment Management Business (Article 28(4) of the FIEA) and Investment Advisory and Agency Business (Article 28(3) of the FIEA), both of which are Financial Instruments Business, there is a difference in the applicable regulations depending on the nature of their respective operations, such as the applicability of subsidiary business regulation (Article 35 and Article 35-2 of the FIEA). Due to such circumstances, there is a question of whether the operations of an asset manager (AM) that are conducted for a Special Purpose Company (SPC) that invests in real estate trust beneficial interests in a real estate securitization scheme are either categorized as Investment Management Business (business pertaining to Discretionary Investment Contract) (Article 2(8)(xii)(b) of the FIEA) or Investment Advisory Business (Article 2(8)(xi) of the FIEA).
2. This is determined by whether or not the SPC has fully or partly entrusted the AM with discretion in making Investment Decisions and has also entrusted the AM with the authority necessary for making investment on behalf of the SPC (Article 2(8)(xii)(b) of the FIEA). “Investment Decisions” is defined as decisions on classes, issues, volumes, or prices of Securities to be invested as well as whether the Securities are purchased or sold and by what method and at what timing, or decisions on contents and timing of Derivative Transactions to be conducted (Article 2(8)(xi)(b) of the FIEA).
3. The determination of the distinction between Discretionary Investment Management Business and Investment Advisory Business should be made not merely based on formal aspects such as contract wording or the type of scheme, but a substantive determination should be made according to the actual conditions of individual cases.

Q8. What is Financial Instruments Intermediary Service?
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- A1. Financial Instruments Intermediary Service is the business of conducting any of the following acts on behalf of a Financial Instruments Business Operator (limited to those that conduct Type I Financial Instruments Business or Investment Management Business) or a Registered Financial Institution under entrustment from them (Article 2(11) of the FIEA):
- (i) intermediary service for sales and purchase of Securities (excluding those categorized as PTS

business);

- (ii) intermediary service for the entrustment of sales and purchase of Securities, Market Transactions of Derivatives, or Foreign Market Derivatives Transactions;
- (iii) dealing in Public Offering or Secondary Distribution of Securities or dealing in Private Placement; or
- (iv) intermediary service for conclusion of Investment Advisory Contracts or Discretionary Investment Contracts.

2. The Financial Instruments Intermediary Service system is characterized by the following: (i) the business is conducted under entrustment from a specific Financial Instruments Business Operator, etc. (Article 2(11) of the FIEA); (ii) the scope of business is limited to intermediary service, and does not allow brokerage and agency service (Article 2(11) of the FIEA); (iii) the service provider is prohibited from receiving a deposit of money or Securities from customers with regard to its Financial Instruments Intermediary Service (Article 66-13 of the FIEA); and (iv) the business adopts the entrusting company system, and an Entrusting Financial Instruments Business Operator, etc. is liable for the damages caused to a customer with regard to the Financial Instruments Intermediary Service rendered by the Financial Instruments Intermediary Service Provider to which it entrusted said service (Article 66-24 of the FIEA).

3. Because Entrusting Financial Instruments Business Operators, etc. are subject to the liability for damages mentioned above (Article 66-24 of the FIEA), those that are able to become an Entrusting Financial Instruments Business Operator, etc. of a Financial Instruments Intermediary Service Provider are limited to those that have a certain financial basis, and they are limited to Financial Instruments Business Operators that conduct Type I Financial Instruments Business or Investment Management Business and Registered Financial Institutions (Article 2(11) and Article 66-2(1)(iv) of the FIEA). As for the scope of persons who are able to become a Financial Instruments Intermediary Service Provider, Financial Instruments Business Operators that conduct Type I Financial Instruments Business can basically conduct any business categorized as Financial Instruments Intermediary Service, so there is little need to specifically permit them to conduct Financial Instruments Intermediary Service, and there will also be a need to avoid causing confusion between business conducted as a Financial Instruments Business Operator and the business conducted as a Financial Instruments Intermediary Service Provider. Therefore, the FIEA provides that Financial Instruments Business Operators conducting Type I Financial Instruments Business cannot become a Financial Instruments Intermediary Service Provider (Article 66-4(vi) and Article 66-19(2) of the FIEA).

Q9. What is Securities-Related Business? Why is such business defined under the FIEA?
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A1. The FIEA defines Securities-Related Business as conducting any of the following acts on a regular basis (Article 28(8)(i) through (viii) of the FIEA; Article 15-2 and Article 15-3 of the FIEA Enforcement Order):

- (i) sales and purchase of Securities, or intermediary, brokerage (excluding Brokerage for Clearing of Securities, etc.), or agency service;
  - (ii) intermediary, brokerage, or agency service for the entrustment of sales and purchase of Securities on Financial Instruments Exchange Markets or Foreign Financial Instruments Markets;
  - (iii) Market Transactions of Derivatives related to Securities;
  - (iv) Over-the-Counter Transactions of Derivatives related to Securities;
  - (v) Foreign Market Derivatives Transactions related to Securities;
  - (vi) intermediary, brokerage (excluding Brokerage for Clearing of Securities, etc.), or agency service for Transactions of Securities-Related Derivatives ((iii) through (v) above) or intermediary, brokerage, or agency service for the entrustment of the transactions set forth in (iii) or (v);
  - (vii) Brokerage for Clearing of Securities, etc. pertaining to sales and purchase of Securities or to Transactions of Securities-Related Derivatives, etc.; or
  - (viii) Underwriting of Securities, Secondary Distribution, dealing in Public Offering/Secondary Distribution, or dealing in Private Placement.
2. In addition, the FIEA uses the concept of Securities-Related Business also for demarcating the following: (i) the Securities subject to the strict separate management obligation imposed on Financial Instruments Business Operators, etc. and those subject to external audit on the state of separate management (Article 43-2 of the FIEA); (ii) the scope of General Customers subject to protection by the Investor Protection Fund (Article 79-20(1) of the FIEA); and (iii) the scope of Financial Instruments Business Operators that are able to use the words “Securities Company” in their names (Article 25(2) of the Supplementary Provisions of the Revising Act).

## **Business regulation**

Q10. How does the FIEA provide for the entry regulation for Financial Instruments Business Operators?

- A1. The FIEA adopts the registration system as a uniform entry regulation for Financial Instruments Business (Article 29 of the FIEA), except for the PTS (proprietary trading system) business, which maintains the authorization system (Article 30(1) of the FIEA). Thus, the previously adopted authorization system for Over-the-Counter Transactions of Derivatives related to Securities and wholesale underwriting business conducted by securities companies, authorization system for investment trust management business and investment corporation asset management business, authorization system for Discretionary Investment Management Business, and license system for commodities investment sales business have been unified into a registration system.
2. Accordingly, a Financial Instruments Business Operator only needs to obtain single registration to conduct any type of Financial Instruments Business, except for the PTS business.

3. Meanwhile, the extent to which investors should be protected by ensuring the financial basis, etc. of the Financial Instruments Business Operator would naturally differ depending on the type of business conducted by the Financial Instruments Business Operator. Therefore, the FIEA has made the entry regulation flexible (ensuring regulatory flexibility) by categorizing Financial Instruments Business into Type I Financial Instruments Business, Type II Financial Instruments Business, Investment Advisory and Agency Business, and Investment Management Business depending on the contents of the business (Article 28(1) through (4) of the FIEA), and providing for tiered requirements for refusal of registration for the respective categories (Article 29-4(1) of the FIEA).

<p>Q11. Is a separate registration procedure required for each category of business of Financial Instruments Business Operators?</p>
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- A1. While the FIEA categorizes Financial Instruments Business into Type I Financial Instruments Business, Type II Financial Instruments Business, Investment Advisory and Agency Business, and Investment Management Business (Article 28(1) through (4) of the FIEA), these categories have only been established in order to make the entry regulation flexible (ensuring regulatory flexibility). It is sufficient for a Financial Instruments Business Operator to follow a single registration procedure under a single registration system for Financial Instruments Business for conducting any of these categories of business.
2. In the meantime, the FIEA provides for tiered requirements for refusal of registration according to the contents of the business conducted by Financial Instruments Business Operators (Article 29-4(1) of the FIEA), which means that a person registered as a Financial Instruments Business Operator cannot necessarily conduct all categories of Financial Instruments Business. It will be determined whether or not the person who intends to be registered as a Financial Instruments Business Operator meets the requirement for refusal of registration for the Category of Businesses (Article 29-2(1)(v) of the FIEA) stated in the written application for registration. When a Financial Instruments Business Operator intends to additionally conduct another Category of Business, the operator needs to follow the procedure for registration of change (Article 31(4) of the FIEA; Article 22 and Appended Form 1 of the Cabinet Office Ordinance on Financial Instruments Business, etc.). In that case, it will be determined whether or not the Financial Instruments Business Operator meets the requirements for refusal of registration for that additional Category of Business (Article 31(5) and Article 29-4 of the FIEA).
3. The Categories of Businesses is defined as the categories of the business of dealing in high liquidity Securities, business of conducting Over-the-Counter Transactions of Derivatives, etc., wholesale underwriting business of holding discussions for fixing the contents of the wholesale underwriting contract, any other wholesale underwriting business, underwriting business other than wholesale underwriting, PTS (proprietary trading system) business, Securities, etc. Management Business, Type II Financial Instruments Business, Investment Advisory and Agency Business, and Investment Management Business (Article 29-2(1)(v) of the FIEA).

Q12. What are the requirements for refusal of registration of Financial Instruments Business Operators?
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A1. The FIEA provides for tiered requirements for refusal of registration according to the category of business conducted by the Financial Instruments Business Operator. If an application of registration meets any of the requirements for refusal of registration, the applicant's registration will be refused (Article 29-4(1) of the FIEA), and if a registered operator meets any such requirement, the operator's registration will be rescinded (Article 52(1)(i) through (iv) of the FIEA).

2. Firstly, the following are the requirements for refusal of registration that are commonly applied to persons who intend to conduct any of the businesses (Article 29-4(1)(i) through (iii)):

(i) a person falling under any of the following:

- a person whose registration as a Financial Instruments Business Operator or the like has been rescinded within the past five years;
- a person who has been sentenced to a fine pursuant to the FIEA or any other Act, and for whom five years have not passed since the day when the execution of the punishment terminated or the person became free from the execution of the punishment;
- a person whose additional business is found to be against public interest; or
- a person who does not have a personnel structure sufficient to conduct Financial Instruments Business in an appropriate manner;

(ii) a juridical person applicant that has a person falling under any of the following among its Officers or its employees specified by Cabinet Order:

- an adult ward/person under curatorship, etc.
- a person who has received a decision of commencement of bankruptcy proceedings and has not obtained restoration of rights, etc.;
- a person who has been sentenced to imprisonment with work or severer punishment, and for whom five years have not passed since the day when the execution of the punishment terminated or the person became free from the execution of the punishment;
- when a juridical person has had its registration as a Financial Instruments Business Operator or the like rescinded, a person who was an Officer of such juridical person within 30 days prior to the rescission, and for whom five years have not passed since the day of the rescission;
- when an individual has had his/her registration as a Financial Instruments Business Operator or the like rescinded, a person for whom five years have not passed since the day of the rescission;
- an Officer, etc. of a Financial Instruments Business Operator, etc. who was ordered for dismissal, and for whom five years have not passed since the day of the disposition; or
- a person who has been sentenced to a fine pursuant to the FIEA or any other Act, and for whom five years have not passed since the day when the execution of the punishment terminated or the person became free from the execution of the punishment; or

- (iii) an individual applicant who falls under any of the requirements under (ii) above or a person who has an employee specified Cabinet Order who falls under any of the requirements under (ii) above.
3. Secondly, the FIEA provides for minimum capital regulation as a requirement for refusal of registration applicable to a person who intends to conduct Type I Financial Instruments Business, Type II Financial Instruments Business, or Investment Management Business (Article 29-4(1)(iv) of the FIEA). Type II Financial Instruments Business, which has no stock company requirement (Article 29-4(1)(v)(a) of the FIEA), can also be conducted by individuals. For an individual that conducts Type II Financial Instruments Business, the FIEA imposes the deposit for operation regulation (Article 31-2) instead of the minimum capital requirement.
4. Thirdly, the FIEA provides for the following as the requirements for refusal of registration applicable to a person who intends to conduct Type I Financial Instruments Business or Investment Management Business (Article 29-4(1)(v) of the FIEA):
- (i) a person other than a stock company (limited to those with a board of directors and company auditors or Committees and a juridical person of the same kind as a company with a board of directors established in compliance with laws and regulations of a foreign state (a foreign juridical person that intends to conduct Type I Financial Instruments Business is limited to a person who engages in the same kind of business and who has a business office or office in Japan));
  - (ii) a person whose Net Assets are less than the prescribed amount;
  - (iii) a person whose other business is neither incidental business nor business subject to notification, and who is found to cause hindrance to the protection of investors due to difficulties in managing risks of loss pertaining to said business;
  - (iv) a juridical person having a Major Shareholder that is an individual who falls under any of the requirements under 2(ii) above, or who is an adult ward or a person under curatorship whose statutory representative falls under any of the requirements under 2(ii) above;
  - (v) a juridical person (excluding a foreign juridical person) having a Major Shareholder that is a juridical person that falls under any of the following:
    - a juridical person whose registration as a Financial Instruments Business Operator or the like has been rescinded within the past five years;
    - a juridical person that has been sentenced to a fine pursuant to the FIEA or any other Act, and for whom five years have not passed since the day when the execution of the punishment terminated or the juridical person became free from the execution of the punishment; or
    - a juridical person that has an Officer who falls under any of the requirements under 2(ii) above;
 or
  - (vi) a foreign juridical person for whom the Foreign Regulatory Agency has not confirmed that a person equivalent to a Major Shareholder has no risk of causing hindrance to sound and appropriate operation of Financial Instruments Business.

5. Fourthly, the FIEA further provides for the following requirements for refusal of registration for a person who intends to conduct Type I Financial Instruments Business (Article 29-4(1)(vi) of the FIEA):
- (i) a person whose capital adequacy ratio is less than 120 percent; or
  - (ii) a person who intends to use the same trade name as that already used by another Financial Instruments Business Operator conducting Type I Financial Instruments Business or a trade name that may be misidentified as another Financial Instruments Business Operator conducting Type I Financial Instruments Business.
6. In this manner, the FIEA provides for the common requirements for refusal of registration as a Financial Instruments Business Operator in Article 29-4(1)(i) through (iii). Then, it provides for additional requirements for refusal of registration for the case of conducting Type I Financial Instruments Business, Type II Financial Instruments Business, or Investment Management Business in item (iv) of that paragraph, those for the case of conducting Type I Financial Instruments Business or Investment Management Business in item (v) of that paragraph, and those for the case of conducting Type I Financial Instruments Business in item (vi) of that paragraph. For example, while only the requirements under items (i) through (iii) of the paragraph are applied to a person who intends to conduct only Investment Advisory and Agency Business, all requirements under the items of that paragraph are applied to a person who intends to conduct Type I Financial Instruments Business. In this way, the FIEA clearly indicates the tiered application of entry regulation, and makes the entry regulation flexible (ensuring regulatory flexibility).

Q13. What is the scope of employees that are subject to examination of the requirements for refusal of registration of Financial Instruments Business Operators?

- A1. Under the FIEA, a juridical person is refused from registration as a Financial Instruments Business Provider not only if its Officer, but also if its employee specified by Cabinet Order (an “important employee”) falls under a requirement for disqualification (Article 29-4(1)(ii) and (iii) of the FIEA). Said Cabinet Order and a Cabinet Office Ordinance under said Cabinet Order provide for the specific scope of “important employees” who are subject to examination of the requirements for disqualification as follows (Article 15-4 of the FIEA Enforcement Order; Article 6 of the Cabinet Office Ordinance on Financial Instruments Business, etc.):
- (i) persons who supervise the business related to providing guidance to have laws and regulations, etc. observed with regard to the Financial Instruments Business and persons who are in a position to exercise the authority of such supervisors on their behalf;
  - (ii) persons who supervise the section which gives advice or makes investments and persons who make Investment Decisions based on values, etc. of Financial Instruments, with regard to Investment Advisory Business or Investment Management Business; and
  - (iii) persons who supervise the business operation of the business office or office with regard to Investment Advisory and Agency Business and persons who are in a position to exercise the

authority of such supervisors on their behalf.

2. The requirements for disqualification of important employees not only become an issue when determining whether or not registration should be refused upon application, but also when determining whether or not registration should be rescinded due to falling under a requirement for refusal of registration ex post facto (Article 52(1)(i) of the FIEA).
3. In the case of a Registered Financial Institution, whether or not an Officer or employee of the financial institution falls under requirements for disqualification does not constitute a requirement for refusal of registration, since Registered Financial Institutions are also subject to the supervision under other business laws, but it should be noted that the financial institution's personnel structure will be examined (Article 33-5(1)(iii) of the FIEA; Article 49 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

<p>Q14. What are the contents of examination standards with regard to the personnel structure requirement for Financial Instruments Business Operators?</p>
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A1. A Cabinet Office Ordinance provides for the following examination standards with regard to the personnel structure requirement for Financial Instruments Business Operators (Article 13 of the Cabinet Office Ordinance on Financial Instruments Business, etc.), and an applicant who falls under any of these is refused to be registered:

- (1) the applicant is found to be unable to appropriately conduct the business in light of the status of securing Officers and employees with sufficient knowledge and experience concerning the business and the organizational structure of the applicant (Article 13(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.);
- (2) the applicant is found to have the risk of causing a loss of confidence in Financial Instruments Business due to having an Officer or employee who has qualities that are inappropriate for conducting business in light of his/her background, relationship with an organized crime group or a member thereof, or any other circumstances (Article 13(ii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.);
- (3) in the case of conducting the business of sales and purchase of real estate trust beneficial interests, etc. (Article 7(vi) of the Cabinet Office Ordinance on Financial Instruments Business, etc.), the applicant fails to satisfy the following requirements (Article 13(iv) of the Cabinet Office Ordinance on Financial Instruments Business, etc.):
  - (i) the applicant allocates Officers and employees with expert knowledge and experience on transactions of building lots and buildings in its supervision section, internal audit section, and compliance guidance section; and
  - (ii) Officers and employees who conduct the business have expert knowledge and experience on transactions of building lots and buildings that are necessary for appropriately explaining the contents of real estate trust beneficial interests, etc. to customers; or
- (4) in the case of conducting specified Investment Management Business related to real estate

(Article 7(vii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.), the applicant fails to satisfy the requirements specified by the FSA Commissioner (Article 13(v) of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

2. Based on the standard set forth in 1(4) above, Financial Services Agency Public Notice No. 54 of 2007 requires that the applicant has been registered as a comprehensive real estate investment advisor as provided under rules on registration of real estate investment advisor business (Ministry of Construction Public Notice No. 1828 of 2000) which is a public notice of the Ministry of Land, Infrastructure, Transport and Tourism, or, in light of the applicant's personnel structure, the applicant is found to have the knowledge and experience required for fairly and appropriately conducting Specified Investment Management Business Related to Real Estate to the same extent as a person who has been registered as such and to have sufficient social credibility.
3. The examination standards with regard to the personnel structure requirement for Registered Financial Institutions are the same as those for Financial Instruments Business Operators (Article 33-5(1)(iii) of the FIEA; Article 49 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

Q15. What are the standards for the minimum capital and Net Assets regulations for Financial Instruments Business Operators?

- A1. For Financial Instruments Business Operators that conduct Type I Financial Instruments Business or Investment Management Business, the minimum capital regulation and the Net Assets regulation are applied as a requirement for refusal of application and grounds for rescission, etc. of registration (Article 29-4(1)(iv) and (v)(b), Article 31(5), and Article 52(1)(ii) and (iii) of the FIEA). The minimum capital regulation is also applied to juridical persons that conduct Type II Financial Instruments Business (Article 29-4(1)(iv) of the FIEA), but for individuals who conduct Type II Financial Instruments Business, not the minimum capital regulation, but the deposit for operation regulation is applied (Article 31-2(1) of the FIEA).
2. The specific amount of the minimum capital for an operator that conducts Type I Financial Instruments Business is to be specified by Cabinet Order (Article 29-4(1)(iv) and Article 30-4(ii) of the FIEA), and Cabinet Order specifies as follows (Article 15-7(1)(i) through (iii) and Article 15-11(1) of the FIEA Enforcement Order):
    - (i) the case of conducting wholesale underwriting of Securities that involves holding of the discussion for fixing the contents of a wholesale underwriting contract with the Issuer or holder of the Securities (Article 28(1)(iii)(a) of the FIEA; Article 15 of the FIEA Enforcement Order; Article 4 of the Cabinet Office Ordinance on Financial Instruments Business, etc.): 3 billion yen;
    - (ii) the case of conducting wholesale underwriting of Securities other than that set forth in (i) above: 500 million yen;
    - (iii) the case of conducting PTS (proprietary trading system) business: 300 million yen; and

(iv) the case of conducting business other than those set forth in (i), (ii), and (iii): 50 million yen.

Cabinet Order also provides for amounts similar to the minimum capital as amounts pertaining to the Net Assets regulation (Article 29-4(1)(v)(b) of the FIEA; Article 15-9(1) of the FIEA Enforcement Order; Article 30-4(iii) and (ii) of the FIEA Enforcement Order; Article 15-11(1) of the FIEA Enforcement Order).

3. Next, the specific amount of the minimum capital for an operator that conducts Investment Management Business is prescribed as 50 million yen under Cabinet Order (Article 29-4(1)(iv) of the FIEA; Article 15-7(1)(iii) of the FIEA Enforcement Order). Again, Cabinet Order provides for the same amounts as the minimum capital as amounts pertaining to the Net Assets regulation (Article 29-4(1)(v)(b) of the FIEA; Article 15-9(1) of the FIEA Enforcement Order).
4. Furthermore, the specific amount of the minimum capital for a juridical person conducting Type II Financial Instruments Business is prescribed as 10 million yen under Cabinet Order (Article 29-4(1)(iv) of the FIEA; Article 15-7(1)(iv) of the FIEA Enforcement Order).

Q16. What are the standards for the deposit for operation regulation for Financial Instruments Business Operators?

- A1. Among Financial Instruments Business Operators, individuals who conduct Type II Financial Instruments Business and operators that conduct Investment Advisory and Agency Business are subject to the deposit for operation regulation (Article 31-2(1) of the FIEA). The specific amount of the deposit for operation is to be specified by Cabinet Order, considering the actual conditions of the Financial Instruments Business Operator's business and the necessity of the protection of investors (Article 31-2(2) of the FIEA).
2. The amount of the deposit for operation for an individual conducting Type II Financial Instruments Business is prescribed as 10 million yen (Article 15-12(i) of the FIEA Enforcement Order), and that for an operator conducting Investment Advisory and Agency Business is prescribed as 5 million yen (Article 15-12(ii) of the FIEA Enforcement Order).

Q17. What is the subsidiary business regulation for Financial Instruments Business Operators?

- A1. Firstly, the FIEA does not impose a subsidiary business regulation on operators that only conduct Type II Financial Instruments Business or Investment Advisory and Agency Business (Article 35-2(1) of the FIEA). It only imposes such regulation on operators that conduct Type I Financial Instruments Business or Investment Management Business (Article 35 of the FIEA). Secondly, the FIEA applies the frameworks of incidental business (Article 35(1) of the FIEA), business subject to notification (Article 35(2) and (3) of the FIEA), and business subject to approval (Article 35(4) of the FIEA) also to operators conducting Investment Management Business, just as in the case of operators conducting Type I Financial Instruments Business. With regard to business subject to approval, the FIEA provides that the Prime Minister may choose not to grant approval only where the implementation of the business is found to go against the public interest or hinder the protection

of investors due to the difficulty in management of the risks of loss arising from the business (Article 35(5) of the FIEA). Thirdly, in consideration of the past situation of subsidiary business of operators conducting Type I Financial Instruments Business or Investment Management Business, the FIEA has newly prescribed consultation/intermediation concerning M&A (Article 35(1)(xi) of the FIEA), consultation concerning business management (Article 35(1)(xii) of the FIEA), and sales and purchase of currencies, etc. (Article 35(1)(xiii) of the FIEA) among others as incidental business, and building lots and buildings transaction business (Article 35(2)(iv) of the FIEA) and real estate specified joint enterprise (Article 35(2)(v) of the FIEA) as business subject to notification.

2. Moreover, Cabinet Office Ordinance has lifted the ban on transactions that make settlement by delivery with regard to Derivative Transactions of commodities, etc., which had been business subject to notification for which only transactions that make settlement by paying or receiving the differences had been allowed (Article 35(2)(ii) of the FIEA; Article 67(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.). In addition to this, it has newly added the following businesses as business subject to notification: intermediary service for concluding contracts on execution of a will or sorting out of inherited property to be conducted by a financial institution engaged in trust business (Article 35(2)(vii) of the FIEA; Article 68(xii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.); management of real estate (Article 68(xiv) of said Cabinet Office Ordinance); emissions transactions, etc. and emissions Derivative Transactions, etc. (Article 68(xvi) and (xvii) of said Cabinet Office Ordinance); business affairs related to the operation of administrative instruments of investment corporations and special purpose companies (Article 68(xviii) of said Cabinet Office Ordinance); management of investment in assets other than Securities/Derivative Transactions (Article 68(xix) of said Cabinet Office Ordinance); guarantee of obligations/assumption of obligations, etc. (Article 68(xx) of said Cabinet Office Ordinance); mediation/introduction of other business operators (Article 68(xxi) of said Cabinet Office Ordinance); and advertising/publicizing conducted with regard to the business of other business operators (Article 68(xxii) of said Cabinet Office Ordinance).

<p><b>Q18. For what kind of business is Sales Representative registration obligated?</b></p>
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A1. The FIEA provides that any Officer or employee of a Financial Instruments Business Operator, etc. who conducts any of the following acts, whatever his/her title is, must be registered as a Sales Representative (Article 64(1) of the FIEA):

- (i) the following acts pertaining to high-liquidity Securities other than Securities equivalents (the items of Article 2(2) of the FIEA):
  - sales and purchase/Market Transactions of Derivatives/Foreign Market Derivatives Transactions, intermediary/brokerage/agency services for these transactions, intermediary/brokerage/agency services for entrustment of these transactions, Brokerage for Clearing of Securities, etc., Secondary Distribution of Securities, or dealing in Public Offering/Secondary Distribution or

dealing in Private Placement of Securities;

- solicitations for applications for sales or purchase or for intermediary/brokerage/agency services for these transactions, solicitations for applications for Market Transactions of Derivatives/Foreign Market Derivatives Transactions or intermediary/brokerage/agency services for these transactions, or solicitations for entrustment of Market Transactions of Derivatives/Foreign Market Derivatives Transactions;

(ii) Over-the-Counter Transactions of Derivatives, etc., Underwriting of Securities, PTS (proprietary trading system) business, or solicitations for applications for Over-the-Counter Transactions of Derivatives, etc.; or

(iii) other acts specified by Cabinet Order.

As acts that fall under (iii) above, Cabinet Order prescribes the following: Market Transactions of Derivatives (e.g., exchange financial futures trading)/Foreign Market Derivatives Transactions that do not fall under (i) above, intermediary/brokerage/agency services for these transactions, intermediary/brokerage/agency services for entrustment of these transactions, solicitations for applications for these transactions, etc., and solicitations for entrustment of these transactions (Article 17-14 of the FIEA Enforcement Order).

2. The regulation concerning Sales Representatives is also applied to Financial Instruments Intermediary Service Providers (Article 66-25 of the FIEA).

## **Scope of business**

Q19. What is the scope of business conducted by Registered Financial Institutions?
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A1. The FIEA adopts a Registered Financial Institution system, and provides that financial institutions can conduct certain Securities-Related Business by obtaining registration (Article 33(2) and Article 33-2 of the FIEA). As well, with regard to Securities that have been newly prescribed under the FIEA such as trust beneficial interests, mortgage securities, and interests in collective investment schemes (Article 2(1)(xiv) and (xvi), Article 2(2)(i), (ii), (v), and (vi), etc. of the FIEA), the FIEA provides that Registered Financial Institutions are able to conduct sales and purchase, intermediary, brokerage, or agency services for these transactions, and Market Transactions of Derivatives, etc. (Article 33(2)(i), (v)(a), and (vi) and Article 33-2(ii) of the FIEA).

2. Next, the FIEA also positions Brokerage with Written Orders as an act that should only be conducted by financial institutions that have obtained registration (Article 33-2(i) of the FIEA).

3. The FIEA provides that Derivative Transactions, etc. (the principal sentence of Article 33(3) of the FIEA) other than Transactions of Securities-Related Derivatives, etc. (the principal sentence of Article 33(3) of the FIEA) are categorized as Financial Instruments Business even when they are conducted by financial institutions (the principal sentence of Article 2(8) of the FIEA), and includes them also in the scope of business of Registered Financial Institutions (Article 33-2(iii) of the FIEA). The same applies to Investment Advisory and Agency Business and self-offering (the

principal sentence and item (iv) of Article 33-2 of the FIEA).

4. While financial institutions have been allowed to receive deposits of Securities for safe custody as incidental business (Article 10(2)(x) of the Banking Act, etc.), the FIEA has positioned such business as Securities, etc. Management Business (Article 28(5) of the FIEA), and included it in the scope of business of Registered Financial Institutions (Article 33(3) and the principal sentence of Article 33-2 of the FIEA), making it subject to application of regulation on activities (Articles 43 through 43-4 of the FIEA).
5. If Brokerage with Written Orders and Investment Advisory Business are conducted in a combined manner, it would be equivalent to a financial institution making a solicitation and providing a brokerage service for sales or purchase of Securities, which would be evasion from the principle prohibiting financial institutions from conducting Securities-Related Business. Therefore, the FIEA explicitly excludes transactions conducted on receiving orders from the customer concerning Investment Advisory Business from the definition of Brokerage with Written Orders (Article 33(2) of the FIEA).

<b>Q20. What is the treatment of Derivative Transactions conducted by business companies?</b>
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- A1. Under the FIEA, not only securities Derivative Transactions, etc. under the former Securities and Exchange Act and financial futures trading, etc. under the former Financial Futures Trading Act, but also currency and interest rate swap transactions, credit derivative transactions, and weather derivative transactions, etc. conducted on a regular basis fall under the category of Financial Instruments Business (Article 2(8)(i) through (iv) and Article 2(20) through (25) of the FIEA).
2. It is construed that an act conducted “on a regular basis” needs to be conducted “repetitively and continuously” and needs to “target the general public.” Thus, an act that is conducted merely for the purpose of improving one’s portfolio is construed not to be an act conducted “on a regular basis” even if it is conducted repetitively and continuously.
3. General business companies may conduct sales or purchase of Securities or the newly added Derivative Transactions in their ordinary business process, but generally, they are considered to conduct such Derivative Transactions in order to hedge their own risks such as weather risks and credit risks. It is considered that such acts generally do not target the general public. Therefore, if a general business company conducts Derivative Transactions within such extent, it is considered unnecessary for the company to be registered as a Financial Instruments Business Operator.
4. Meanwhile, when a business company that engages in sales and purchase of goods, etc., such as a trading company, conducts non-deliverable forward (NDF) transactions or over-the-counter currency option transactions with domestic customers in order to hedge the domestic customers’ exchange risks upon providing intermediation for import and export transactions between domestic customers and foreign business operators, such act is only conducted as a means to fix the sales or purchase price in import or export transactions by yen currency and it is considered not to be substantially independent, investment-type financial transactions. However, it cannot be concluded

that such act “does not target the general public and therefore is not categorized as an act conducted on a regular basis.” Also, in the case of a corporate group, when the parent company conducts an act that is categorized as Over-the-Counter Transactions of Derivatives related to currencies with a subsidiary company in order to hedge the exchange risks involved in the assets or liabilities held by the subsidiary company, such act has a strong aspect of being conducted for integrated risk management within the corporate group, and there seems to be little need to make such act subject to business regulation. However, again, it cannot be concluded that such act “is not categorized as an act conducted on a regular basis.” Therefore, the FIEA and related Cabinet Order and Cabinet Office Ordinance clearly exclude such acts from the definition of Financial Instruments Business, as acts that are found not to hinder the protection of investors in consideration of the contents of such acts (the principal sentence of Article 2(8) of the FIEA; Article 1-8-6(1)(iv) of the FIEA Enforcement Order; Article 16(1)(iii) and (iv) of the Definition Ordinance).

5. In addition, the FIEA and related Cabinet Order and Cabinet Office Ordinance clearly exclude Derivative Transactions, etc. unrelated to Securities that are conducted with a person who is found to have expert knowledge and experience concerning Derivative Transactions or a stock company, etc. whose stated capital exceeds a certain amount from the definition of Financial Instruments Business as the counterparty (the principal sentence of Article 2(8) of the FIEA; Article 1-8-6(1)(ii) of the FIEA Enforcement Order). On the other hand, in order to thoroughly ensure the protection of investors, the acts excluded from the definition of Financial Instruments Business are limited to those that are truly found to cause no hindrance. Specifically, such acts are excluded from the definition of Financial Instruments Business only if they are conducted with a Financial Instruments Business Operator (limited to those that conduct Type I Financial Instruments Business), Registered Financial Institution, Qualified Institutional Investors, etc., or stock company whose stated capital is 1 billion yen or more or Specific Purpose Company whose specified capital is 1 billion yen or more as the counterparty (Article 15 of the Definition Ordinance; Financial Services Agency Public Notice No. 53 of 2007).
6. Meanwhile, a person who is able to become a member of a Financial Instruments Exchange or become qualified as a Trading Participant is limited to a Financial Instruments Business Operator, etc. (Article 91, Article 112(1), and Article 113 of the FIEA). Therefore, a general business company who is not a Financial Instruments Business Operator, etc. cannot become a member of a Financial Instruments Exchange or become qualified as a Trading Participant in order to conduct Market Transactions of Derivatives.

<p>Q21. What is the outline of the scope of business of Financial Instruments Business Operators?</p>
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A1. The FIEA imposes the following regulation on the scope of business for Financial Instruments Business Operators that conduct Type I Financial Instruments Business or Investment Management Business (Article 35 of the FIEA).

- (1) First, such Financial Instruments Business Operator can conduct Financial Instruments

Business as well as business incidental thereto (incidental business) by operation of law (Article 35(1) of the FIEA). The incidental business includes the businesses listed in the items of Article 35(1) of the FIEA as well as those that are “any other business incidental to Financial Instruments Business.”

(2) Next, such Financial Instruments Business Operator can conduct the businesses listed in the items of Article 35(2) of the FIEA by making notification (business subject to notification) (Article 35(2) and (3) of the FIEA; Article 69 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

(3) Furthermore, such Financial Instruments Business Operator can conduct businesses other than incidental business and business subject to notification by obtaining approval (business subject to approval) (Article 35(4) of the FIEA). When an application for approval is filed, the Prime Minister may choose not to grant approval only when the business is found to go against the public interest or hinder the protection of investors due to the difficulty in management of the risks of loss arising from the business (Article 35(5) of the FIEA; Article 70 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

2. Regulation on the scope of business is not applied to Financial Instruments Business Operators that only conduct Type II Financial Instruments Business or Investment Advisory and Agency Business (Article 35-2(1) of the FIEA).

Q22. What is the scope of incidental business conducted by Financial Instruments Business Operators?

A1. The businesses which Financial Instruments Business Operators that conduct Type I Financial Instruments Business or Investment Management Business can conduct as those incidental to Financial Instruments Business by operation of law and which are clearly indicated under laws and regulations are as follows:

- (i) the lending and borrowing of Securities, etc. (Article 35(1)(i) of the FIEA);
- (ii) money loan incidental to a margin transaction (Article 35(1)(ii) of the FIEA);
- (iii) money loan secured by Securities that are deposited for safe custody from customers (Article 35(1)(iii) of the FIEA; Article 65 of the Cabinet Office Ordinance on Financial Instruments Business, etc.);
- (iv) agency service for customers concerning Securities (Article 35(1)(iv) of the FIEA);
- (v) agency service of the business pertaining to payment of earnings / redemption money / cancellation money with regard to beneficial interest in the investment trust of a settlor company of an investment trust, or the business pertaining to delivery of the Securities or any other assets belonging to the trust property pertaining to beneficial interest in the investment trust (Article 35(1)(v) of the FIEA);
- (vi) agency service of the business pertaining to distribution of money, distribution of refunds/residual assets, or payment of interest/redemption money with regard to Investment

- Securities, etc. of an investment corporation (Article 35(1)(vi) of the FIEA);
  - (vii) conclusion of a Contract for Cumulative Investment (Article 35(1)(vii) of the FIEA; Article 66 of the Cabinet Office Ordinance on Financial Instruments Business, etc.);
  - (viii) provision of information or advice in relation to Securities (excluding acts falling under the category of Investment Advisory Business) (Article 35(1)(viii) of the FIEA);
  - (ix) agency service of the business of any Counterparty Financial Business Operator, etc. (Article 35(1)(ix) of the FIEA);
  - (x) retention of assets of a registered investment corporation (Article 35(1)(x) of the FIEA);
  - (xi) consultation/intermediation with regard to M&A (Article 35(1)(xi) of the FIEA);
  - (xii) consultation with regard to business management (Article 35(1)(xii) of the FIEA);
  - (xiii) sales and purchase of currencies or intermediary/brokerage/agency services for these transactions (Article 35(1)(xiii) of the FIEA);
  - (xiv) sales and purchase of negotiable deposits and other monetary claims or intermediary/brokerage/agency services for these transactions (Article 35(1)(xiv) of the FIEA); and
  - (xv) investment of Investment Property in the specified assets defined in Article 2(1) of the Act on Investment Trusts and Investment Corporations (excluding building lots and buildings) (Article 35(1)(xv) of the FIEA; Article 15-25 of the FIEA Enforcement Order).
2. In addition to the above, incidental business also includes businesses that are “any other business incidental to Financial Instruments Business” (the principal sentence of Article 35(1) of the FIEA).

Q23. What is the scope of business subject to notification conducted by Financial Instruments Business Operators?

- A. The scope of business subject to notification that can be conducted by a Financial Instruments Business Operator conducting Type I Financial Instruments Business or Investment Management Business by making notification is as follows:
- (i) transactions on a commodity market, etc. (Article 35(2)(i) of the FIEA);
  - (ii) commodity derivative transactions (both transactions that make settlement by delivery and transactions that make settlement by paying or receiving the differences) (Article 35(2)(ii) of the FIEA; Article 67 of the Cabinet Office Ordinance on Financial Instruments Business, etc.);
  - (iii) business pertaining to money lending business or other money loan, or intermediary service of lending and borrowing of money (Article 35(2)(iii) of the FIEA);
  - (iv) building lots and buildings transaction business or lease of building lots or buildings (Article 35(2)(iv) of the FIEA);
  - (v) real estate specified joint enterprise (Article 35(2)(v) of the FIEA);
  - (vi) management of investment in commodities (Article 35(2)(v)-2 of the FIEA);
  - (vii) management of investment of Investment Property in assets other than Securities or rights arising from Derivative Transactions (building lots/buildings, etc.) (Article 35(2)(vi) of the FIEA);

- FIEA);
- (viii) sales and purchase of gold bullion or intermediary/brokerage/agency services for these transactions (article 35(2)(vii) of the FIEA; Article 68(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.);
  - (ix) conclusion of partnership contracts or intermediary/brokerage/agency services for such act (Article 68(ii) of said Cabinet Office Ordinance);
  - (x) conclusion of anonymous partnership agreements or intermediary/brokerage/agency services for such act (Article 68(iii) of said Cabinet Office Ordinance);
  - (xi) conclusion of loan participation contracts or intermediary/brokerage/agency services for such act (Article 68(iv) of said Cabinet Office Ordinance);
  - (xii) insurance solicitation (Article 68(v) of said Cabinet Office Ordinance);
  - (xiii) lease of real estate which the operator owns (Article 68(vi) of said Cabinet Office Ordinance);
  - (xiv) business of leasing goods (Article 68(vii) of said Cabinet Office Ordinance);
  - (xv) creation/sales of computer programs and receiving entrustment of calculation related to business of other business operators (Article 68(viii) of said Cabinet Office Ordinance);
  - (xvi) business of operating and managing defined contribution pensions (Article 68(ix) of said Cabinet Office Ordinance);
  - (xvii) affairs related to defined contribution pensions entrusted by the National Pension Fund Association (Article 68(x) of said Cabinet Office Ordinance);
  - (xviii) trust contract agency business (Article 68(xi) of said Cabinet Office Ordinance);
  - (xix) intermediary service for concluding contracts on execution of a will or sorting out of inherited property to be conducted by a financial institution engaged in trust business (Article 68(xii) of said Cabinet Office Ordinance);
  - (xx) financial institution agency service (bank agency service, etc.) (Article 68(xiii) of said Cabinet Office Ordinance);
  - (xxi) real estate management business (Article 68(xiv) of said Cabinet Office Ordinance);
  - (xxii) advisory business concerning investment in real estate (Article 68(xv) of said Cabinet Office Ordinance);
  - (xxiii) emissions transactions or intermediary/brokerage/agency services for these transactions (Article 68(xvi) of said Cabinet Office Ordinance);
  - (xxiv) emissions derivative transactions, etc. or intermediary/brokerage/agency services for these transactions (Article 68(xvii) of said Cabinet Office Ordinance);
  - (xxv) business affairs related to the administrative operation of investment corporations and special purpose companies (Article 68(xviii) of said Cabinet Office Ordinance);
  - (xxvi) management of investment in assets other than Securities/Derivative Transactions (Article 68(xix) of said Cabinet Office Ordinance);
  - (xxvii) guarantee of obligations/assumption of obligations, etc. (Article 68(xx) of said Cabinet Office Ordinance);

- (xxviii) mediation/introduction of other business operators (Article 68(xxi) of said Cabinet Office Ordinance);
- (xxix) advertising/publicizing conducted with regard to the business of other business operators (Article 68(xxii) of said Cabinet Office Ordinance);
- (xxx) funds transfer service (Article 68(xxiii) of said Cabinet Office Ordinance); and
- (xxxi) business incidental to business subject to notification (Article 68(xxiv) of said Cabinet Office Ordinance).

## **Professional Investors and General Investors**

Q24. What are the outline and purpose of the system for distinguishing between Professional Investors and General Investors?

- A1. The FIEA categorizes investors into Professional Investors and General Investors, and applies regulation on activities to Financial Instruments Business Operators, etc. according to this category, in order to ensure regulatory flexibility.
2. Specifically, flexibility has been achieved in the regulation as follows.
- (i) When business operators conduct transactions with General Investors, sufficient regulation on activities is applied from the viewpoint of protecting investors.
  - (ii) The FIEA positions persons who are considered to be able to conduct appropriate risk management with regard to financial transactions in light of the status of their knowledge/experience/property as Professional Investors. When business operators conduct transactions with Professional Investors, they are excluded from application of regulation on activities that is intended for correcting the information gap, such as the obligation to deliver a document prior to the conclusion of a contract. However, they are not excluded from application of the regulation of activities that is also intended for ensuring fairness of the market, such as prohibition of Compensation of Loss, etc. (Article 2(31), Articles 34 through 34-5, and Article 45 of the FIEA).
3. In addition, while also using the systems of other major countries and regions as reference, the FIEA allows customers to shift their status from a General Investor to a Professional Investor, and vice versa, on their own choice in certain cases.
4. The Report of the First Subcommittee mentions the following as the intention and purpose of introducing such a system.
- (i) It is possible to appropriately protect users and facilitate the supply of risk/capital at the same time by categorizing investors into Professional Investors and General Investors.
  - (ii) Professional Investors will be adequately protected under the principle of suitability, in light of their knowledge/experience/property, and they do not necessarily seek protection under administrative regulation.
  - (iii) By letting Professional Investors operate under market discipline, rather than administrative

regulation, transaction costs that would arise in relation to overregulation will be eliminated, and transactions in Japan's financial and capital markets facing global competition will be facilitated further.

Q25. What is the scope of Professional Investors?
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- A1. With regard to categorization of Professional Investors and General Investors, the Report of the First Subcommittee, using the systems of other major countries and regions as reference, indicates an idea to start with two categories of Professional Investors and General Investors, and assumes the following four categories considering the optional shifting of the status of investors:
- (i) Professional Investors who cannot shift their status to General Investors;
  - (ii) Professional Investors who can shift their status to General Investors by choice;
  - (iii) General Investors who can shift their status to Professional Investors by choice; and
  - (iv) General Investors who cannot shift their status to Professional Investors.
2. The FIEA defines “Professional Investors” to be Qualified Institutional Investors, the State, the Bank of Japan, and Investor Protection Funds and any other juridical persons specified by Cabinet Office Ordinance (Article 2(31) of the FIEA). Among these, Qualified Institutional Investors, the State, and the Bank of Japan fall under the category of “Professional Investors who cannot shift their status to General Investors” in (i) above.
3. On the other hand, Professional Investors that are “Investor Protection Funds and any other juridical persons specified by Cabinet Office Ordinance” can be regarded as General Investors (fully receive the protection under regulation just as in the case of General Investors) if they request a Financial Instruments Business Operator, etc. to treat them as a “customer other than a Professional Investor” (General Investor) and follow a prescribed procedure (Article 34-2 of the FIEA), and they fall under the category of “Professional Investors who can shift their status to General Investors by choice” in (ii) above. Specifically, Cabinet Office Ordinance provides for the following juridical persons (Article 23 of the Definition Ordinance):
- juridical persons incorporated by a specific act of incorporation pursuant to the provisions of any specific Act;
  - Investor Protection Funds;
  - the Deposit Insurance Corporation of Japan;
  - the Agricultural and Fishery Cooperative Savings Insurance Corporation;
  - the Insurance Policyholders Protection Corporation of Japan;
  - Specific Purpose Companies;
  - issuer companies of listed share certificates;
  - stock companies whose stated capital is expected to amount to 500 million yen or more, reasonably judging from the status of the transactions thereof or any other circumstances;
  - Financial Instruments Business Operators, or juridical persons that fall under the category of Specially Permitted Business Notifying Persons; and

- foreign juridical persons.

4. Furthermore, juridical persons other than Professional Investors (Article 34-3(1) of the FIEA) and individuals who satisfy certain requirements as being equivalent to Professional Investors in light of the status of their knowledge/experience/property (Article 34-4(1) of the FIEA) can be regarded by a Financial Instruments Business Operator, etc. as Professional Investors, if they request the Financial Instruments Business Operator, etc. to treat them as Professional Investors and follow a prescribed strict procedure. These fall under the category of “General Investors who can shift their status to Professional Investors by choice” in (iii) above.

All other individuals fall under the category of “General Investors who cannot shift their status to Professional Investors” in (iv) above.

Q26. How are foreign investors treated?
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- A1. The Professional Investor system under the FIEA classifies customers eligible to be protected by way of regulation and applies regulation in accordance with the customer classes, thereby ensuring regulatory flexibility. Therefore, investors not eligible to be protected by way of regulation are not covered by the Professional Investor system in the first place.
2. As the FIEA is basically intended to protect residents in Japan, foreign investors who are non-residents are presumed to not necessarily be eligible for protection. However, foreign investors (non-residents) are presumed to be eligible for protection and to be covered by the Professional Investor system when Financial Instruments Business Operators, etc. sell products to them or solicit them as customers in Japan, for example.
3. When Financial Instruments Business Operators, etc. conduct transactions with foreign juridical persons in Japan, it is presumed to not always be necessary to apply various investor protection laws. In light of this as well as convenience, etc. for foreign investors (non-residents), foreign juridical persons among foreign investors (non-residents) are treated as "Professional Investors who may change their status to general investors as an Option" (Article 2(31)(iv) of the FIEA; Article 23(x) of the Definition Ordinance).
4. On the other hand, individual foreign investors are treated in the same way as domestic individual investors. However, with regard to individuals who are managers of Partnerships, etc. based on foreign laws and regulations, it is presumed to be difficult to check whether they meet the requirements for "Professional Investors who may change their status to general investors as an Option" given the diverse types of Partnerships, etc. based on foreign laws and regulations. Therefore, in order to facilitate the conduct of practical affairs and for other objectives, such individuals are not treated as "Professional Investors who may change their status to general investors as an Option" (see Article 34-4(1)(i) of the FIEA; Article 61(2) of the Financial Instruments Business Ordinance). It should be noted that individuals who are managers of Anonymous Partnerships, those who are operating partners of partnerships as specified by the Civil

Code, or those who are involved in decisions on the execution of important business operations of limited liability partnerships and execute them are treated as "Professional Investors who may change their status to general investors as an Option" under certain conditions (Article 34-4(1)(i) of the FIEA; Article 61 of the Financial Instruments Businesses Ordinance).

<p>Q27. Which part of the regulation on activities is not applied to Professional Investors?</p>
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- A1. Since Professional Investors are considered to be capable of conducting appropriate risk management with regard to financial transactions in light of the status of their knowledge/experience/property, if the counterparty to a transaction is a Professional Investor, the Financial Instruments Business Operator, etc. is excluded from application of the regulation on activities applicable to Financial Instruments Business Operators, etc. that is intended to correct the information gap between the operator and the customer, except for the regulation intended for ensuring fairness of the market, such as prohibition of Compensation of Loss, etc., in order to ensure regulatory flexibility (Article 45 of the FIEA).
2. Specifically, such Financial Instruments Business Operator, etc. is excluded from application of the following regulation on activities. However, this does not apply to certain cases where the public interest or protection of Professional Investors is likely to be hindered (the proviso to Article 45 of the FIEA; Article 156 of the Cabinet Office Ordinance on Financial Instruments Business, etc.):
- (i) if the counterparty to the solicitation of transactions conducted by the operator is a Professional Investor, regulation on advertising, etc. (Article 37 of the FIEA), prohibition of unrequested solicitation (Article 38(iv) of the FIEA), obligation to confirm the intention to receive solicitation (Article 38(v) of the FIEA), prohibition of repeated solicitations (Article 38(vi) of the FIEA), and the principle of suitability (Article 40(i) of the FIEA);
  - (ii) if the person who makes and offers transactions to the operator, or the counterparty to the transactions conducted by the operator, is a Professional Investor, the obligation to clarify the conditions of transactions in advance (Article 37-2 of the FIEA), obligation to deliver a document prior to the conclusion of a contract (Article 37-3 of the FIEA), obligation to deliver a document upon conclusion of a contract, etc. (Article 37-4 of the FIEA), obligation to deliver a document pertaining to receipt of a security deposit (Article 37-5 of the FIEA), paper-based cancellation (Article 37-6 of the FIEA), obligation to deliver a document stating the Best Execution Policy, etc. in advance (Article 40-2(4) of the FIEA), and restriction on the act of furnishing a customer's securities as security (Article 43-4 of the FIEA);
  - (iii) if the counterparty to an Investment Advisory Contract concluded by the operator is a Professional Investor, prohibition of receiving of deposits of money or Securities, etc. (Article 41-4 of the FIEA), and prohibition of loans, etc. of money or Securities (Article 41-5 of the FIEA); and
  - (iv) if the counterparty to a Discretionary Investment Contract concluded by the operator is a Professional Investor, prohibition of receiving of deposits of money or Securities, etc. (Article

42-5 of the FIEA), prohibition of loans, etc. of money or Securities (Article 42-6 of the FIEA), and obligation to deliver investment reports (Article 42-7).

3. While the principle of suitability (Article 40(i) of the FIEA) is not applied when making solicitation of transactions to Professional Investors, the principle will apply when General Investors shift their status to Professional Investors by choice. For example, if a Financial Instruments Business Operator, etc. solicits a customer that is unsuitable to become a Professional Investor in light of the customer's knowledge/experience/property to shift the status to a Professional Investor by choice, it would be a violation of the principle of suitability.

<b>Q28. What kind of regulation on activities is applied to Professional Investors?</b>
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A. Regulation on activities intended for ensuring fairness of the market and basic obligations pertaining to fiduciary responsibility are applied irrespective of whether the counterparty to transactions of a Financial Instruments Business Operator, etc. is a General Investor or a Professional Investor. Specifically, the following regulation on activities is applied:

- (i) with regard to all businesses, duty of good faith and fairness to customers (Article 36 of the FIEA), posting of signs (Article 36-2 of the FIEA), prohibition of name lending (Article 36-3 of the FIEA), and prohibition of administration of corporate bonds, etc. (Article 36-4 of the FIEA);
- (ii) with regard to sales/solicitation, etc., prohibition of providing false information (Article 38(i) of the FIEA), prohibition of providing conclusive evaluations, etc. (Article 38(ii) of the FIEA), prohibited acts (Article 38(vii) and Article 38-2 of the FIEA), prohibition of Compensation of Loss, etc. (Article 39 of the FIEA), appropriate handling of customer information, etc. (Article 40(ii) of the FIEA), and prohibition of sales and purchase, etc. where separate management is not ensured (Article 40-3 of the FIEA);
- (iii) with regard to Investment Advisory Business, duty of loyalty to customers (Article 41(1) of the FIEA), duty of due care of a prudent manager (Article 41(2) of the FIEA), prohibited acts (Article 41-2 of the FIEA), and prohibition of sales and purchase of Securities, etc. (Article 41-3 of the FIEA); and
- (iv) with regard to Investment Management Business, duty of loyalty to customers (Article 42(1) of the FIEA), duty of due care of a prudent manager (Article 42(2) of the FIEA), prohibited acts (Article 42-2 of the FIEA), entrustment of authority of investment (Article 42-3 of the FIEA), and separate management (Article 42-4 of the FIEA).

<b>Q29. What kinds of exceptions are provided for with regard to regulation on activities that is not applied to transactions with Professional Investors?</b>
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- A1. The FIEA provides that it is possible to provide for exceptions to regulation on activities that are not applied to transactions with Professional Investors, that is, to provide for cases where the regulation on activities is applied (the proviso to Article 45 of the FIEA).
2. First, obligation to deliver a document upon conclusion of a contract, etc. (Article 37-4 of the

FIEA), obligation to deliver a document pertaining to receipt of a security deposit (Article 37-5 of the FIEA), and obligation to deliver investment reports (Article 42-7) are applied even with regard to transactions with Professional Investors, if the business operator does not have a framework for promptly answering inquiries from customers (Professional Investors) (Article 156(i), (ii), and (iv) of the Cabinet Office Ordinance on Financial Instruments Business, etc.). The specific framework to be established should be appropriately determined from the viewpoint of securing the convenience of Professional Investors, while also considering the status of business operations of the respective Financial Instruments Business Operators, etc.

3. In addition, prohibition of receiving deposits of money or Securities, etc. (Article 41-4 and Article 42-5 of the FIEA) is applied even with regard to transactions with Professional Investors, if the business operator does not have a framework for separately managing the deposited money or Securities (Article 156(iii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

Q30. The FIEA provides that the shifting of the status between a Professional Investor and a General Investor is to be made for each Kind of Contract, but what are the different Kinds of Contracts?

- A1. The procedure for shifting the status between a Professional Investor and a General Investor under the FIEA respects the intention of the investor about whether or not to receive full protection under regulation on activities, from the viewpoint of protecting investors, such as having investors make a request for the shifting of the status on their own choice.
2. Whether or not individual investors are able to conduct appropriate risk management with regard to financial transactions is considered to depend on the type of transactions. Therefore, the shifting of the status between a Professional Investor and a General Investor is to be made for each Kind of Contract (Article 34-2(1), Article 34-3(1), and Article 34-4(1) of the FIEA).
3. Meanwhile, if the Kind of Contract is overly subdivided, the system could become complicated, and the workload of practical affairs, such as managing the investor categories (Professional Investors or General Investors), could become too heavy. Accordingly, the FIEA provides for the following four Kinds of Contracts in order to keep the categorization simple: (i) contracts related to Securities transactions; (ii) contracts related to Derivative Transactions; (iii) Investment Advisory Contracts and contracts for providing agency/intermediary services for the conclusion thereof; and (iv) Discretionary Investment Contracts and contracts for providing agency/intermediary services for the conclusion thereof (Article 34 of the FIEA; Article 53 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

Q31. What is the scope of individuals who can be treated as Professional Investors?

- A1. From the viewpoint of ensuring the protection of individual investors, the FIEA basically positions all individual investors as General Investors, and allows only those that satisfy certain requirements as those whose status of knowledge/experience/property is equivalent to that of

Professional Investors to request a shift of their status to Professional Investors by choice (Article 34-4 of the FIEA).

2. As for the specific requirements for an individual who can request a shift of his/her status to a Professional Investor, firstly, an individual who is a business operator of an anonymous partnership, an individual who is an operating partner of a partnership under the Civil Code, or an individual who is a partner involved in and that executes important business operations of a Limited Liability Partnership must satisfy the following requirements (Article 34-4(1)(i) of the FIEA; Article 61 of the Cabinet Office Ordinance on Financial Instruments Business, etc.):
  - (i) the consent of all other partners has been obtained with regard to requesting a shift of the status; and
  - (ii) the total amount of contribution under the partnership contract, etc. is 300 million yen or more. Such individuals are considered to be able to shift their status to Professional Investors only in relation to business operation of such anonymous partnership or business execution of such partnership under the Civil Code, etc.
3. Secondly, the FIEA provides that the general individuals need to satisfy all of the following requirements in order to make such a request (Article 34-4(1)(ii) of the FIEA; Article 62 of the Cabinet Office Ordinance on Financial Instruments Business, etc.):
  - (i) the total amount of Net Assets on the Date of Acceptance is expected to be 300 million yen or more, reasonably judging from the status of transactions and any other circumstances;
  - (ii) the total amount of investment-type financial assets on the Date of Acceptance is expected to be 300 million yen or more, reasonably judging from the status of transactions and any other circumstances; and
  - (iii) one year has passed since the day of first concluding a contract that falls under the Kind of Contract pertaining to the request.

Since it is considered difficult for Financial Instruments Business Operators, etc. to accurately identify the contents of assets and liabilities of individual customers, the FIEA requires that a level of 300 million yen or more is “expected” by “reasonably judging” from various circumstances.

## **Regulation on activities**

### **- Regulation on activities of Financial Instruments Business Operators, etc.**

Q32. What is the outline of regulation on activities under the FIEA?
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- A1. In order to ensure the application of rules for protection of users, the FIEA applies rules to Financial Instruments/transactions having the same economic nature. By doing so, the FIEA positions itself as a law having general characteristics concerning sales/solicitation of Financial Instruments, and applies its regulation on activities (sales/solicitation rules) across-the-board, irrespective of the business category, also to Financial Instruments/transactions that are subject to

the existing legal system for protecting users.

2. The FIEA provides for the following as specific regulation on activities applied to Financial Instruments Business Operators, etc. (Financial Instruments Business Operators or Registered Financial Institutions) (Article 34 of the FIEA):
  - (i) with regard to all businesses, duty of good faith and fairness to customers (Article 36 of the FIEA), posting of signs (Article 36-2 of the FIEA), prohibition of name lending (Article 36-3 of the FIEA), and prohibition of administration of corporate bonds, etc. (Article 36-4 of the FIEA);
  - (ii) with regard to sales/solicitation, etc., regulation on advertising, etc. (Article 37 of the FIEA), obligation to clarify the conditions of transactions in advance (Article 37-2 of the FIEA), obligation to deliver a document prior to the conclusion of a contract (Article 37-3 of the FIEA), obligation to deliver a document upon conclusion of a contract, etc. (Article 37-4 of the FIEA), obligation to deliver a document pertaining to receipt of a security deposit (Article 37-5 of the FIEA), cancellation by means of a document (cooling off) (Article 37-6 of the FIEA), prohibited acts (prohibition of providing false information / providing conclusive evaluations, etc. / solicitation using a rating by an unregistered rating agency / unrequested solicitations / failure to confirm the intention to receive solicitation / repeated solicitations, etc.) (Article 38 of the FIEA), prohibition of Compensation of Loss, etc. (Article 39 of the FIEA), the principle of suitability, etc. (Article 40 of the FIEA), obligation to deliver a document stating the Best Execution Policy, etc. in advance (Article 40-2 of the FIEA), and prohibition of sales and purchase, etc. where separate management is not ensured (Article 40-3 of the FIEA);
  - (iii) with regard to Investment Advisory and Agency Business (Article 28(3) of the FIEA) and Investment Management Business (Article 28(4) of the FIEA), prohibited acts (Article 38-2);
  - (iv) with regard to Investment Advisory Business (Article 28(6) of the FIEA), duty of loyalty to customers/duty of due care of a prudent manager (Article 41 of the FIEA), prohibited acts (Article 41-2 of the FIEA), prohibition of sales and purchase of Securities, etc. (Article 41-3 of the FIEA), prohibition of receiving of deposit of money or Securities, etc. (Article 41-4 of the FIEA), and prohibition of loan, etc. of money or Securities (Article 41-5 of the FIEA);
  - (v) with regard to Investment Management Business, duty of loyalty to customers/duty of due care of a prudent manager (Article 42 of the FIEA), prohibited acts (Article 42-2 of the FIEA), entrustment of authority of investment (Article 42-3 of the FIEA), separate management (Article 42-4 of the FIEA), prohibition of receiving of deposits of money or Securities, etc. (Article 42-5 of the FIEA), prohibition of loans, etc. of money or Securities (Article 42-6 of the FIEA), and obligation to deliver investment reports (Article 42-7);
  - (vi) with regard to Securities, etc. Management Business (Article 28(5) of the FIEA), duty of due care of a prudent manager (Article 43 of the FIEA), separate management (Article 43-2 and Article 43-3 of the FIEA), and restriction on the act of furnishing a customer's securities as security (Article 43-4 of the FIEA); and
  - (vii) as measures for preventing detriments, etc., prohibited acts when engaging in two or more

categories of businesses (Article 44 of the FIEA), prohibited acts pertaining to other businesses (Article 44-2 of the FIEA), restriction on acts involving parent juridical persons, etc./subsidiary juridical persons, etc. (Article 44-3 of the FIEA), and restriction on credit granting by an underwriter (Article 44-4 of the FIEA).

3. For business operators that are not categorized as Financial Instruments Business Operators such as banks, insurance companies, and trust companies, the respective business laws such as the Banking Act, the Insurance Business Act, and the Trust Business Act provide for necessary arrangements, including application mutatis mutandis of the regulation on activities under the FIEA, and thereby secure treatment equivalent to the regulation on activities under the FIEA.

Q33. What kind of provisions does the FIEA have with regard to fiduciary responsibility?
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A1. The FIEA has the following provisions on fiduciary responsibility:

- (i) it obligates Financial Instruments Business Operators, etc. and their Officers/employees to execute business in good faith and fairly to customers (Article 36 of the FIEA);
- (ii) it imposes on Financial Instruments Business Operators, etc. the duty of loyalty and duty of due care of a prudent manager when conducting Investment Advisory Business (Article 41 of the FIEA);
- (iii) it imposes on Financial Instruments Business Operators, etc. the duty of loyalty and duty of due care of a prudent manager (Article 42 of the FIEA) and obligation of separate management (Article 42-4 of the FIEA), and prohibits them from entrusting the entire authority of investment with regard to all Investment Property (Article 42-3(2) of the FIEA) as representation of the self-executing obligation, when conducting Investment Management Business; and
- (iv) it imposes Financial Instruments Business Operators, etc. the duty of due care of a prudent manager (Article 43 of the FIEA) and obligation of separate management (Article 43-2 and Article 43-3 of the FIEA) when conducting Securities, etc. Management Business.

Q34. What is the scope of application of the regulation on advertising, etc.?
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- A1. In order to ensure application of rules for protection of users, when Financial Instruments Business Operators, etc. advertise, etc. the contents of the Financial Instruments Business they conduct, the FIEA obligates them to indicate certain matters, and prohibits them from making an indication that is significantly contradictory to facts or seriously misleading with regard to the outlook of profits (Article 37 of the FIEA).
2. In this manner, the regulation on advertising, etc. is applied to advertising, etc. by Financial Instruments Business Operators, etc. The regulation is not considered to be applied to advertising, etc. by a Financial Instruments Firms Association which is a self-regulating organization, or by a newspaper company or a publishing company. On the other hand, even if advertising is formally not under the name of a Financial Instruments Business Operator, etc., if it is found to be conducted by a Financial Instruments Business Operator, etc. in substance, it would be subject to the

regulation on advertising, etc.

3. In addition, the FIEA applies the regulation to advertising of the “contents” of Financial Instruments Business (Article 2(8) of the FIEA). It should be noted that whether or not advertising meets this requirement should always be substantively determined for individual cases according to the actual conditions of the case, such as the contents and the purpose of advertising, given the intention of the regulation to ensure application of the rules for protection of users.
4. Furthermore, the FIEA defines the advertising, etc. to which this regulation applies as “advertising” and “conducting any similar acts” (acts similar to advertising) (Article 37(1) of the FIEA). Since the advertising media and method are irrelevant, the regulation also applies to broadcasting media, such as television and radio, the Internet, billboards/standing signboards, and outdoor advertisements. Meanwhile, Cabinet Office Ordinance prescribes the specific scope of acts similar to advertising to be the provision of information with the same contents to many persons by postal mail, correspondence delivery, facsimile, email, distribution of flyers or pamphlets, or any other method (Article 72 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).
5. Therefore, when Financial Instruments Business Operators, etc. advertise the contents of the Financial Instruments Business they conduct, as long as it is provisions of information with the same contents to many persons, materials used for sales, for example, will also be subject to the regulation on advertising, etc.
6. On the other hand, advertising by way of providing the following is excluded from the scope of acts similar to advertising as being acts that are not considered to require application of the regulation on advertising, etc. (the items of Article 72 of said Cabinet Office Ordinance): (i) documents prepared based on laws and regulations, etc. (e.g., Prospectuses and investment reports); (ii) analyst reports (materials concerning analysis/evaluation of individual companies which are not used for soliciting conclusion of contracts); and (iii) novelty goods that meet certain requirements.

Q35. What kind of obligation of explanation is imposed on business operators against customers?
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- A1. In consideration that it is appropriate to position an obligation of explanation with the same contents as that under the Act on Sales, etc. of Financial Instruments, which is a civil obligation, as regulation on activities under business law, the FIEA provides that a Financial Instruments Business Operator, etc. must deliver a document stating the outline of the Contract for Financial Instruments Transaction, fees, information on risks, and other matters to customers prior to conclusion of a Contract for Financial Instruments Transaction (“pre-contract document”) (Article 37-3(1) of the FIEA). When a business operator violates this obligation, a supervisory disposition can be directly invoked.
2. In light of the intention of the obligation of explanation, it is considered necessary that information required for a customer to determine whether or not to conclude a Contract for Financial Instruments Transaction is substantively provided to the customer. From such a viewpoint, (i) the Act on Sales, etc. of Financial Instruments adopts the idea of the principle of suitability as the

standard for interpreting the obligation of explanation (Article 3(2) of the Act on Sales, etc. of Financial Instruments), and (ii) in line with this, the FIEA provides for obligation of substantive explanation with regard to the pre-contract document (Article 38(vii) of the FIEA; Article 117(1)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

Q36. Is it sufficient for a business operator to deliver a document in advance, in order to fulfill the obligation of explanation to a customer?

- A1. It is said that the obligation of explanation is business operators' obligation to provide information on important matters concerning Financial Instruments to users, and can be regarded as a relative disclosure obligation. It is positioned as a pillar of sales/solicitation rules for protection of users, along with the principle of suitability (First Subcommittee of the Financial System Council, "First Interim Report" (July 6, 1999)).
2. While the FIEA provides for the obligation of explanation in the form of obligation of delivery of a pre-contract document (Article 37-3(1) of the FIEA), such arrangement was made in consideration of matters including the following (Article 40 of the Securities and Exchange Act; Article 70 of the Financial Futures Trading Act, etc.): (i) consistency should be achieved with the obligation to deliver a Prospectus (Article 15(2) of the FIEA), which is a relative disclosure obligation under disclosure regulation; (ii) in non-face-to-face transactions via electronic media, explanation through an electronically delivered document will be the core; and (iii) the obligation had been provided for in the form of obligation of delivery of a pre-contract document under the former finance-related laws.
  3. In light of the intention of the obligation of explanation, it is not sufficient for a Financial Instruments Business Operator, etc. to merely deliver a document stating the stipulated matters formally, but it is necessary that the operator substantively provide the customer with important information that will be required for the customer to determine whether or not to conclude a Contract for Financial Instruments Transaction (see Article 3(2) of the Act on Sales, etc. of Financial Instruments).
  4. Given that the obligation of explanation is an obligation to provide information on important matters, it is necessary to prevent the obligation from losing its substance, and to substantiate the rule. From such a viewpoint, with regard to delivery of a pre-contract document, Cabinet Office Ordinance has added to prohibited acts an act of concluding a Contract for Financial Instruments Transaction without providing in advance an explanation by the method and to the extent necessary for the customer to understand the contents in light of the customer's attributes (the status of knowledge, experience and property and the purpose of concluding the Contract for Financial Instruments Transaction) (Article 38(vii) of the FIEA; Article 117(1)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.).
  5. Under this obligation of substantive explanation, business operators are considered necessary to flexibly change the method and the extent of the explanation in light of the diverse customer

attributes and according to the contents of the contracts. It should be noted that, with regard to the mode, etc. of explanation, importance is attached to the substantive aspect of whether the customer will understand the contents of the document in light of the customer's attributes, rather than the formal/procedural aspects, and that it is not necessarily sufficient to use a specific formal procedure/method. Also, since whether or not the customer has actually understood the contents of the document can only be subjectively judged by the customer, and cannot be judged by other persons, the FIEA does not require the customer to have "understood" the contents as a result of receiving an explanation from the business operator. Business operators are considered to be required to basically provide an explanation by the method and to the extent that is judged to be necessary for a customer having the same attributes as the customer in question to "understand" the contents based on social conventions, and on such basis, adopt the method and extent that are appropriate for each customer.

<p><b>Q37. What are the matters to be stated in a pre-contract document?</b></p>
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A1. A pre-contract document needs to contain matters that are necessary and important for general users to determine whether or not to conduct the transactions, such as information on the contract, information on risks, information on transaction costs, and information on the business operator. From such a viewpoint, the FIEA provides for the following as matters that should be commonly stated in all pre-contract documents (Article 37-3(1) of the FIEA; Article 82 of the Cabinet Office Ordinance on Financial Instruments Business, etc.):

- (i) the trade name or name and address of the Financial Instruments Business Operator, etc.;
- (ii) the fact that the business operator is a Financial Instruments Business Operator, etc. and the operator's registration number;
- (iii) the outline of the Contract for Financial Instruments Transaction;
- (iv) the fees to be payable by the customer, etc.;
- (v) if there is possible loss of principal (due to market risks), such fact;
- (vi) if there is possible loss exceeding principal (due to market risks), such fact;
- (vii) the fact that the contents of the pre-contract document be read thoroughly;
- (viii) if there is customer margin, etc. payable by the customer, its amount and calculation method;
- (ix) if there is possible loss of principal as set forth in (v) above, the indicator that will be the direct cause for such loss and the reason therefor;
- (x) if there is possible loss exceeding principal as set forth in (vi) above, the indicator that will be the direct cause for such loss and the reason therefor;
- (xi) if there is possible loss of principal (due to credit risks of the business operator or any other person), such fact, such person, and the reason therefor;
- (xii) if there is possible loss exceeding principal (due to credit risks of the business operator or any other person), such fact, such person, and the reason therefor;
- (xiii) the outline of taxes relating to the contract;

- (xiv) if there are any predetermined causes for termination of the contract, their contents;
- (xv) whether or not cooling off provisions are applicable;
- (xvi) if cooling off provisions are applicable, their contents;
- (xvii) the outline of the Financial Instruments Business Operator, etc.;
- (xviii) the outline of the contents and method of the Financial Instruments Business (or Registered Financial Institution Business) conducted by the Financial Instruments Business Operator, etc.;
- (xix) the method by which the customer contacts the Financial Instruments Business Operator, etc.;
- (xx) whether or not the Financial Instruments Business Operator, etc. is a member of a Financial Instruments Firms Association or a Target Business Operator of a Certified Investor Protection Organization, and if it is a member or a Target Business Operator, the name of the association or organization; and
- (xxi) if there is a Designated Dispute Resolution Organization, the trade name or name of the organization, and if there is no such organization, the contents of the Complaint Processing Measures and Dispute Resolution Measures.

2. In addition to these common matters to be stated, additional matters to be stated are stipulated in detail according to the characteristics of the Financial Instruments/transactions (Articles 83 through 96 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

<p><b>Q38. What is the method of making statements in a pre-contract document?</b></p>
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- A1. The method of making statements in a pre-contract document, of which preparation/delivery are obligated under the FIEA, is divided into three steps, according to the importance, etc. of the matters to be stated (the principal sentence of Article 37-3(1) of the FIEA; Article 79 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).
2. First, the Financial Instruments Business Operator, etc. is obligated to plainly state the “fact that the pre-contract document should be read adequately” (Article 82(i) of said Cabinet Office Ordinance) and the “matters set forth in the items of Article 37(1) of the Act which are particularly important matters that affect the determination of customers” by using characters/numbers in the size of 12 points or larger (Article 79(3) of said Cabinet Office Ordinance). The latter assumes a simple and plain statement of the outline of the contract (Article 37-3(1)(iii) of the FIEA) and matters concerning fees, etc. (Article 37-3(iv) of the FIEA) that are particularly important, and the fact that there is possible loss of principal/loss exceeding principal (Article 37-3(v) and (vi) of the FIEA), among other matters.
  3. Secondly, the Financial Instruments Business Operator, etc. is obligated to clearly and accurately state the following matters within frames by using characters/numbers in the size of 12 points or larger (Article 79(2) of the Cabinet Office Ordinance on Financial Instruments Business, etc.):
    - (i) the outline of the fees, etc.;
    - (ii) the fact that there is possible loss of principal / loss exceeding principal / the relevant indicator, etc. / the reason therefor;

- (iii) the trade name, etc. of the counterparty to the covering transactions of over-the-counter financial futures trading, and the method/trustee of separate management; and
  - (iv) whether or not cooling off provisions are applicable.
4. Thirdly, the Financial Instruments Business Operator, etc. is obligated to clearly and accurately state any other matters to be stated by using characters/numbers in the size of 8 points or larger (Article 79(1) of said Cabinet Office Ordinance).
  5. It is desirable for a Financial Instruments Business Operator, etc. to satisfy these statutory requirements as well as to voluntarily take original measures to arouse the attention of the customer (e.g., underlining or changing the text color in certain parts).

Q39. How should the obligation for explanation be fulfilled in the case of transactions that are not conducted face-to-face?

- A1. The obligation for substantive explanation as specified by the FIEA and a related ordinance (Article 38(vii) of the FIEA; Article 117(1)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.) places emphasis on substance, namely, whether customers accurately understand the contents of the pre-contract document, etc., regardless of whether the transaction is conducted face-to-face or otherwise (via an ATM, the Internet, etc.).
2. In the case of transactions that are not conducted face-to-face in particular, it is considered to be necessary in light of their nature to devise practical measures to fulfill the obligation for substantive explanation, such as (i) ascertaining that customers have adequately read the pre-contract document, etc., (ii) developing a system to appropriately respond to customers' inquiries and (iii) publishing a FAQ concerning matters about which inquiries are frequently received.
3. One example of such a practical measure cited by the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc. is ascertaining customers' understanding through such means as enabling customers to indicate their understanding with the click of a button on their computer display after reading explanations shown on the display when they conduct financial instruments transactions via the Internet.
4. In any case, whether the obligation to provide explanations to customers is fulfilled in accordance with the above provision should be judged substantively in light of the circumstances of each case.

Q40. What is the scope of fees, etc. which a business operator must disclose to the customer?

- A1. The amount of fees, remuneration or any other consideration payable by the customer to a Financial Instruments Business Operator, etc. with regard to a Contract for Financial Instruments Transaction has a direct impact on the customer's return. Therefore, the FIEA requires the business operator to indicate the outline of the fees, etc. when advertising, etc. (Article 37(1)(iii) of the FIEA; Article 16(1)(i) of the FIEA Enforcement Order), and to state the fees, etc. in the pre-contract document (Article 37-3(1)(iv) of the FIEA).
2. The specific scope of fees, etc. to be disclosed is prescribed to be "the consideration payable by the

customer with regard to a Contract for Financial Instruments Transaction, irrespective of what the consideration is called, such as fees, remuneration, or cost” excluding “the price of Securities or the amount of security deposit, etc.” (Article 74(1) and Article 81(1) of the Cabinet Office Ordinance on Financial Instruments Business, etc.). Therefore, the scope will include (i) not only the fees, etc. directly payable by the customer to the business operator, such as stock trade commissions and sales commissions for investment trusts, (ii) but also fees, etc. indirectly payable by the customer to the business operator, such as trust fees for investment trusts and expenses, etc. related to investment of variable pensions. It is also clearly indicated for confirmation that, in the case of investment trusts in the form of fund of funds, the fees, etc. such as trust fees pertaining to funds to be invested in are included (Article 74(2) through (4) and Article 81(2) of said Cabinet Office Ordinance).

3. In order to ensure application of rules for protection of users, it is important that the customer is able to accurately understand overall fees, etc. that are payable to the Financial Instruments Business Operator, etc. with regard to the Contract for Financial Instruments Transaction. From such a viewpoint, the business operator is also obligated to indicate/state the “amount (or calculation method) for each type of fees, etc.” in addition to their “total amount (or calculation method)” (Article 74(1) and Article 81(1) of said Cabinet Office Ordinance). Meanwhile, considering the diversity/complexity of the fees, etc., the business operator is permitted to state/indicate the “maximum amount (or calculation method)” for each type of fees, etc. (Article 81(1) of said Cabinet Office Ordinance). Moreover, in the case of advertising, etc., it is sufficient to indicate the overall “outline,” considering space limitations, etc. (Article 74(1) of said Cabinet Office Ordinance).
4. When it is not possible to indicate/state such information pertaining to fees, etc., the business operator will indicate/state such fact and the reason therefor (the proviso to Article 74(1) and the proviso to Article 81(1) of said Cabinet Office Ordinance). However, it should be noted that a case where the “maximum amount (or calculation method)” can be indicated/stated does not fall under the “case where it is not possible to indicate/state such information.”

Q41. Is the sales commission payable by the producer (e.g., an insurance company) of a Financial Instrument to its seller (e.g., a bank, etc.) included in the fees, etc. that must be disclosed?

- A1. With regard to sales commissions payable by the producer of a Financial Instrument to its seller, the Report of the First Subcommittee mentions that “although we cannot deny the possibility that the amount of sales commissions would affect the sales/solicitation conducted by the seller in some aspects, we consider that there are still issues that need to be studied, such as the extent to which such disclosure obligation should be applied (e.g., the treatment of sales compensation provided as part of the salary of sales persons).”
2. Based on the Report of the First Subcommittee, the FIEA provides for “matters concerning fees, remuneration or any other consideration payable by the customer with regard to said Contract for

Financial Instruments Transaction” as the fees, etc. subject to disclosure (Article 37-3(1)(iv) of the FIEA, etc.), and does not include therein the fees, etc. payable by the producer of a Financial Instrument to its seller. The treatment of such fees, etc. will continue to be studied in the future.

3. It is possible for a Financial Instruments Business Operator, etc. to voluntarily disclose information on such fees, etc. to customers from the viewpoint of securing their trust.

<p>Q42. In what kind of cases is the delivery of a pre-contract document unnecessary?</p>
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- A1. The pre-contract document under the FIEA is to be prepared/delivered for each contract, in principle (Article 37-3(1) of the FIEA), but exceptions are allowed in certain cases where non-delivery of such document will not hinder the protection of investors, considering the characteristics of the transaction and the convenience of users (the proviso to Article 37-3(1) of the FIEA).
2. The first exception is the case where the business operator has delivered a “document on listed Securities, etc.” within the past one year with regard to sales and purchase of listed Securities, etc. (Article 80(1)(i) and (3) of the Cabinet Office Ordinance on Financial Instruments Business, etc.).
3. The second exception is the case where the business operator has delivered a pre-contract document of the “same kind of contents” to the customer within the past one year (Article 80(1)(ii) and (4) of said Cabinet Office Ordinance). In order to receive application of this exception, it is considered sufficient to deliver the document to the customer periodically at intervals not exceeding one year. Whether or not Contracts for Financial Instruments Transactions can be regarded to have the “same kind of contents” should be substantively determined in light of social conventions from the viewpoint of customers for individual cases. A particularly important factor in such determination would be whether or not such information as the risk information (Article 37-3(1)(v) and (vi) of the FIEA; Article 82(iii) through (vi) of the Cabinet Office Ordinance on Financial Instruments Business, etc.) provided to the customer through the pre-contract documents of the respective contracts are the same. Therefore, basically, the documents would at least differ (i) for the respective kinds of Securities listed in the items of Article 2(1) and the items of Article 2 of the FIEA with regard to Securities, and (ii) for the transactions with different transaction category/underlying assets (“Financial Instruments”) / reference indicator (“Financial Indicator”) with regard to Derivative Transactions.
4. The third exception is the case where the business operator has delivered a Prospectus, etc. to the customer (Article 80(1)(iii) of said Cabinet Office Ordinance). In order to receive application of this exception, the Prospectus must contain all matters to be stated in the pre-contract document, but supposing the case where some of those matters (e.g., the outline of the seller or the specific level of the sales commissions) are not contained in the Prospectus, the business operator is also allowed to deliver a document stating such information together with the Prospectus. Meanwhile, the case where delivery of a Prospectus is unnecessary (Article 15(2)(ii) of the FIEA) also does not require delivery of a pre-contract document (Article 80(1)(iii) of said Cabinet Office Ordinance).

5. The fourth exception is the case where the business operator intends to conclude a contract that partially changes the contents of an already concluded contract, and there is no change in the matters to be stated in the pre-contract document or a contract change document has been delivered to the customer (Article 80(1)(iv) of said Cabinet Office Ordinance).
6. The fifth exception is the case where the contract pertains to any of the following acts: sales of Securities purchased; intermediary or agency service for the purchase of Securities pertaining to a Tender Offer; purchase of Beneficiary Securities of Investment Trusts/foreign investment trusts; the contrary sales or purchase of Securities transactions/Derivative Transactions; sales or purchase under a Contract for Cumulative Investment, etc.; re-investment of earnings from investment trusts, etc. or sales or purchase (excluding initial sales) / cancellation of money reserve funds (MRF); Underwriting of Securities; dealing in Public Offering or Secondary Distribution of Securities or dealing in Private Placement or dealing in Solicitation for Selling, etc. Only for Professional Investors (Article 80(1)(v) of said Cabinet Office Ordinance).

Q43. What is a document on listed Securities, etc.?
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- A1. The pre-contract document under the FIEA is to be prepared/delivered for each contract, in principle (Article 37-3(1) of the FIEA), but exceptions are allowed in certain cases considering the characteristics of the transactions and the convenience of users, etc. (the proviso to Article 37-3(1) of the FIEA).
2. For example, listed instruments, etc. have stylized instrument quality, have a certain level of social recognition, have undergone the examination for listing, etc. by the Financial Instruments Exchange, and are disclosed by way of making them available for public inspection. Considering such points, it is provided that in the case of sales or purchase, etc. of listed Securities, etc. (sales or purchase, etc. (excluding Derivative Transactions/margin transactions, etc.) of listed Securities (excluding covered warrants, etc.) in or outside Japan), it is unnecessary to prepare/deliver a pre-contract document if a “document on listed Securities, etc.,” which is a comprehensive document, has been delivered within the past one year (Article 80(1)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.).
3. The requirement of “within the past one year” has been set on the basis that the information needs to have been provided to the customer at least within the past one year from the viewpoint of investor protection, considering the possibility of diversification of listed instruments, etc. Meanwhile, if the customer makes sales or purchase, etc. of listed Securities, etc. within one year after the delivery of such document, the customer is considered to have the necessary information at that point of time, so it is regarded that the document on listed Securities, etc. has been re-delivered at that point of time (Article 80(3) of said Cabinet Office Ordinance). Therefore, unless the interval between transactions exceeds one year, the exclusion from application will remain effective.
4. In a document on listed Securities, etc., the following matters are to be stated by a method

equivalent to the method for stating matters in a pre-contract document (Article 79 of said Cabinet Office Ordinance) (Article 80(1)(i) of said Cabinet Office Ordinance):

- (i) the trade name or name and address of the Financial Instruments Business Operator, etc.;
- (ii) the fact that the business operator is a Financial Instruments Business Operator, etc. and the operator's registration number;
- (iii) the outline of the Contract for Financial Instruments Transaction;
- (iv) the fees to be payable by the customer, etc.;
- (v) if there is possible loss of principal (due to market risks), such fact;
- (vi) the fact that the contents of the document should be read thoroughly;
- (vii) if there is possible loss of principal (due to market risks), the indicator that will be the direct cause for such loss and the reason therefor;
- (viii) if there is possible loss of principal (due to credit risks of the business operator or any other person), such fact, such person, and the reason therefor;
- (ix) an outline of the Financial Instruments Business Operator, etc.;
- (x) whether or not the Financial Instruments Business Operator, etc. is a member of a Financial Instruments Firms Association or a Target Business Operator of a Certified Investor Protection Organization, and if it is a member or a Target Business Operator, the name of the association or organization; and
- (xi) if there is a Designated Dispute Resolution Organization, the trade name or name of the organization, and if there is no such organization, the contents of the Complaint Processing Measures and Dispute Resolution Measures.

5. In a document on listed Securities, etc., it is considered to be necessary to state information on the target listed Securities, etc. in as much detail as possible. For example, when Securities with different instrument quality from existing listed instruments are to be newly listed, it would be necessary to deliver a document on listed Securities, etc. which accurately states such instrument quality (an outline of the contract, risk information, etc.).

Q44. What kind of document needs to be delivered upon conclusion of a contract?
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- A1. Under the obligation to deliver a document upon conclusion of a contract etc. under the FIEA (Article 37-4(1) of the FIEA), firstly, the business operator is obligated to deliver an “upon-contract document” which is a document for enabling the customer to confirm the contents of the Contract for Financial Instruments Transaction concluded.
2. Secondly, in the case of cancellation of an investment trust / foreign investment trust (Article 98(1)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.) or refunding of investment equity of an investment corporation (Article 98(1)(ii) of said Cabinet Office Ordinance), the business operator is obligated to deliver a document for enabling the customer to confirm the contents thereof, although it is not “conclusion of a Contract for Financial Instruments Transaction.”

3. Thirdly, the business operator is obligated to deliver a “transaction balance report” for reporting the contents of the transactions carried out with the customer within a certain period and the balance of Securities/money as of the last day of that period (Article 98(1)(iii) of said Cabinet Office Ordinance). As for delivery of a transaction balance report, (i) if the customer requests the delivery of the report every time a contract is established or Securities/money have been transferred, it needs to be delivered upon every such timing (Article 98(1)(iii)(a) of said Cabinet Office Ordinance), (ii) and if the customer has not made such a request, it needs to be delivered every three months (Article 98(1)(iii)(b) of said Cabinet Office Ordinance). However, the business operator is allowed to deliver the report on an annual basis if no transaction is carried out with the customer for one year, and does not require delivery of the report if there is neither a transaction, etc. nor a balance for one year.
4. Fourthly, when a contract pertaining to commodity fund related transactions (the principal sentence of Article 91(1) of said Cabinet Office Ordinance) has been concluded with the customer, it is necessary to deliver a report on the investment status of the commodity fund (Article 98(1)(iv) and Article 98(2) of the FIEA).

<p>Q45. In what kind of cases is delivery of an upon-contract document unnecessary?</p>
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A1. Delivery of an “upon-contract document” is unnecessary in such cases as where it is considered unnecessary to deliver a document every time a contract is established or where the customer is able to confirm the contents of the contract by another document. Specifically, the FIEA provides for the following cases (the proviso to Article 37-4(1) of the FIEA; Article 110(1)(i) through (vii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.):

- (i) the case of purchase under a Contract for Cumulative Investment, etc., re-investment of earnings from investment trusts / foreign investment trusts, etc., or sales or purchase/cancellation of MRF, on the condition that the business operator periodically delivers the document to the customer and has a framework for answering inquiries;
- (ii) the case of sales or purchase of bonds on condition of repurchase/resale, transactions for which the period from the contract date to the delivery date is one month or more, sales or purchase of bonds with an option, Over-the-Counter Transactions of Derivatives, intermediary/brokerage/agency services for sales where the Issuer/holder of Securities is the customer, intermediary/agency services for purchase of Securities pertaining to a Tender Offer, or dealing in Public Offering / Secondary Distribution / Private Placement where the Issuer / holder of Securities is the customer, on the condition of delivering a written contract stating the terms and conditions of the transactions every time a contract is made;
- (iii) the case of establishment of a contract pertaining to Brokerage for Clearing of Securities, etc. conducted by a Clearing Participant;
- (iv) the case of dealing with Problematic Conduct;
- (v) the case of a transaction, etc. under a Discretionary Investment Contract that requires the

consent, etc. of the customer;

(vi) the case of partially changing the contents of a contract where there is no change in the matters to be stated in the upon-contract document or where a document stating the changed matters has been delivered to the customer; or

(vii) the case of a give-up action.

2. In addition, delivery of a transaction balance report is unnecessary in the following cases (the proviso to Article 37-4(1) of the FIEA; Article 111(i) through (iv) of the Cabinet Office Ordinance on Financial Instruments Business, etc.):

(i) the case where the customer, who is a foreign government, etc., has given the consent to non-delivery of the report, and the business operator has a framework for answering inquiries;

(ii) the case of intermediary/agency services for Securities pertaining to a Tender Offer;

(iii) the case where transfer of Securities/money pertains to Underwriting of Securities;

(iv) the case where establishment of a contract or transfer of Securities/money pertains to dealing in Public Offering / Secondary Distribution / Private Placement of Securities where the Issuer/holder of the Securities is the customer;

(v) sales or purchase or any other transactions of Securities or Derivative Transactions, etc. that do not involve transfer of Securities or money; or

(vi) the case of a give-up action.

3. Moreover, delivery of a report on the investment status of the commodity fund is also unnecessary in cases where the customer is a person who satisfies certain requirements (the proviso to Article 37-4(1) of the FIEA; Article 112 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

Q46. What kind of prohibited acts are specified by Cabinet Office Ordinance?
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A1. Article 38 of the FIEA individually lists prohibited acts that commonly apply to all Financial Instruments Business Operators, etc. (Article 38(i) through (vi) of the FIEA), and further provides that “acts that result in insufficient protection of investors, harm the fairness of transactions or cause a loss of confidence in Financial Instruments Business” will be specified by Cabinet Office Ordinance (Article 38(vii) of the FIEA).

2. The specific contents of Cabinet Office Ordinance have been stipulated by using the former related laws and regulations as reference (Article 117 of the Cabinet Office Ordinance on Financial Instruments Business, etc.), whereas the main changes made at the time of enacting the FIEA are as follows:

(i) In order to ensure the obligation of substantive explanation, with regard to delivery of a pre-contract document, etc., Cabinet Office Ordinance has added to prohibited acts an act of concluding a contract without providing in advance an explanation by the method and to the extent necessary for the customer (excluding a Professional Investor) to understand the contents in light of the customer’s attributes (Article 117(1)(i) of said Cabinet Office Ordinance).

- (ii) Cabinet Office Ordinance prohibits an act of providing or promising to provide special benefits with regard to a Contract for Financial Instruments Transaction (Article 117(1)(iii) of said Cabinet Office Ordinance).
- (iii) Cabinet Office Ordinance prohibits solicitations during the time of the day that would annoy the customer with regard to all Contracts for Financial Instruments Transaction in the case of individual customers, and prohibits such acts with regard to mortgage securities / commodity funds / financial futures trading in the case of any other customers (Article 117(1)(vii) of said Cabinet Office Ordinance).
- (iv) In order to prevent evasion of the prohibition of unrequested solicitation (Article 38(iv) of the FIEA) and the prohibition of repeated solicitations (Article 38(vi) of the FIEA), Cabinet Office Ordinance prohibits an act of making a solicitation by gathering customers (excluding Professional Investors) without clearly indicating that the purpose is solicitation of over-the-counter financial futures trading (Article 117(1)(viii) of the Cabinet Office Ordinance on Financial Instruments Business, etc.), and prohibits an act of making a solicitation in spite of the fact that the customer (excluding a Professional Investor) has expressed his/her intention to not conclude a contract (including the expression of not wishing to receive solicitation) in advance with regard to financial futures trading (Article 117(ix) of said Cabinet Office Ordinance).
- (v) Cabinet Office Ordinance has provisions prohibiting securities companies from becoming involved in market manipulation, which also cover involvement in market manipulation concerning market indicators such as the market VWAP (volume weighted average price) and the transaction volume (Article 117(1)(xix) and (xx) of the Cabinet Office Ordinance on Financial Instruments Business, etc.

Q47. In what kind of cases is the confirmation on Problematic Conduct, which is usually required in order for a case to be excluded from prohibition of Compensation of Loss, unnecessary?

- A1. The FIEA provides that the provisions on prohibition of Compensation of Loss, etc. do not apply when compensation is made “in order to compensate in whole or in part a loss incurred from Problematic Conduct,” and, in principle, requires “confirmation on the Problematic Conduct” by the authorities in order for the case to be excluded from application of those provisions (Article 39(3) of the FIEA; Article 118 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).
- 2. However, as a measure to further facilitate Compensation of Losses to customers in the event of Problematic Conduct, it is provided that confirmation on the Problematic Conduct is not necessary (the proviso to Article 39(3) of the FIEA; Article 119(1) of the Cabinet Office Ordinance on Financial Instruments Business, etc.) when an objective procedure has been taken to be able to presume that the compensation is made for a loss caused by Problematic Conduct without having the authorities make confirmation on the Problematic Conduct.

3. Specifically, confirmation on the Problematic Conduct is not necessary in the following cases:
- (i) a final and binding judgment of a court (Article 119(1)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.);
  - (ii) a judicial settlement (Article 119(1)(ii) of said Cabinet Office Ordinance);
  - (iii) civil conciliation (Article 119(1)(iii) of said Cabinet Office Ordinance);
  - (iv) mediation by a Financial Instruments Firms Association or a Certified Investor Protection Organization, or a settlement by a Designated Dispute Resolution Organization (Article 119(1)(iv) of said Cabinet Office Ordinance);
  - (v) a settlement/arbitration by the arbitration center of a bar association (Article 119(1)(v) of said Cabinet Office Ordinance);
  - (vi) a settlement through mediation by the National Consumer Affairs Center of Japan or the consumer center of a local government (Article 119(1)(vi) of said Cabinet Office Ordinance);
  - (vii) a settlement through a certified dispute resolution procedure conducted by a certified dispute resolution business operator (limited to those whose target disputes cover Sales and Purchase or Other Transaction of Securities, etc.) under the Act on Promotion of Use of Alternative Dispute Resolution (the ADR Act) (Article 119(1)(vii) of said Cabinet Office Ordinance);
  - (viii) a settlement through representation of the customer by an attorney-at-law/judicial scrivener who satisfies certain requirements<sup>(note)</sup> (Article 119(1)(viii) of said Cabinet Office Ordinance)
- (Note) The amount of payment is not more than 100 million yen (in the case of an attorney-at-law) or not more than 1.4 million yen (in the case of a judicial scrivener), and a document proving that the attorney-at-law/judicial scrivener investigated/confirmed that the compensation is made for a loss caused by a Problematic Conduct has been delivered to the Financial Instruments Business Operator, etc.;
- (ix) a settlement involving a committee that satisfies certain requirements (Article 119(1)(ix) of said Cabinet Office Ordinance);
  - (x) the case where the property benefit to be provided to the customer is not more than 100,000 yen (Article 119(1)(x) of said Cabinet Office Ordinance); and
  - (xi) the case where the representative person, etc. of the Financial Instruments Business Operator, etc. has caused a loss to the customer due to an error in the execution of the customer's order (Article 119(1)(xi) of said Cabinet Office Ordinance).

Q48. What kind of revision was made to the principle of suitability?
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A1. The principle of suitability is a principle that should constitute a pillar of sales/solicitation rules for protection of users, along with the obligation of prior explanation (the business operator's obligation to provide information on the Financial Instruments to users). It is said that there is the "principle of suitability in the narrow sense" (a rule that a business operator must not conduct sales/solicitation of certain instruments to specific users regardless of how much detailed explanation the business operator provides) and the "principle of suitability in the broad sense" (a rule that a business operator must conduct sales/solicitation in a way that suits the

knowledge/experience/property, etc. of the users). It is understood that the principle of suitability is that in the narrow sense, and that the principle of suitability in the broad sense is equivalent to a concept that has expanded the obligation of explanation.

2. The rules similar to the principle of suitability under the Banking Act and the Insurance Business Act, etc. not only require development of an appropriate framework (see Article 13-7 of the Ordinance for Enforcement of the Banking Act; Article 53-7 of the Ordinance for Enforcement of the Insurance Business Act, etc.), but, from the viewpoint of achieving cross-sectoral application of regulation, also apply *mutatis mutandis* the principle of suitability under the FIEA (the rule prohibiting “solicitation that is found to be inappropriate”) with regard to investment-type deposits/insurance, etc., and thereby secure treatment equivalent to the regulation on activities under the FIEA (Article 13-4 of the FIEA; Article 300-2 of the Insurance Business Act).
3. The FIEA applies the idea of the “principle of suitability in the broad sense” to the obligation of explanation, and prohibits an act of concluding a contract without providing in advance an explanation by the method and to the extent necessary for the customer to understand the contents in light of the customer’s attributes (the status of knowledge/experience/property and the purpose of concluding the contract), with regard to delivery of a pre-contract document, etc. (Article 117(1)(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.). The Act on Sales, etc. of Financial Instruments also adopts the idea of the principle of suitability as the standard for interpreting the obligation of explanation (Article 3(2) of the FIEA).

Q49. What matters should be taken into consideration when applying the principle of suitability?
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- A1. In the actual practice of sales/solicitation of Financial Instruments/transactions, the business operator would need to take the following two-step approach under the principle of suitability:
- (i) determine whether or not it is permissible to conduct sales/solicitation of certain instruments/transactions to the customer, in light of the customer’s attributes (“the principle of suitability in the narrow sense”); and
  - (ii) even if it is judged to be permissible to conduct sales/solicitation, provide an explanation by the method and to the extent necessary for the customer to understand the contents in light of the customer’s attributes (“the principle of suitability in the broad sense”).
2. With regard to the specific application of the principle, the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc. mention that the business operator must ensure that investment solicitation is conducted in an appropriate manner suited to their customer’s attributes, etc., and for such purpose, it is important to establish a control environment for customer management that enables a precise identification of the customer's attributes and the actual status of transactions. From such a viewpoint, the guidelines indicate (i) efforts for securing of an appropriate identification of customer attributes and appropriate management of customer information, and (ii) precise identification of the actual status of customers' transactions and effective use of acquired information, as major supervisory viewpoints.

3. In association with this, when an individual customer desires a certain investment-type instrument, there can be a case where the customer refuses to answer questions for confirming the customer's attributes. However, if the business operator immediately takes a response to refrain from conducting the transaction with such customer, it could excessively hinder the convenience of customers. In addition, it is considered to be necessary to comprehensively take into account the knowledge/experience, etc. of the customer in observing the principle of suitability.
4. The principle of suitability is simply intended for seeking business operators to take a diverse and flexible response according to the attributes of individual customers. Therefore, a response of uniformly refraining from conducting sales/solicitation to customers who are older than a certain age or a response of impairing the convenience of users with rich knowledge/experience, etc. by uniformly providing an explanation for long hours, disregarding the knowledge/experience, etc. of individual customers, is considered not to comply with the intention of the principle of suitability.
5. Meanwhile, since "the principle of suitability in the narrow sense" is regulation on activities pertaining to "solicitation," it is not applied when no solicitation is involved. For example, an act of providing an explanation on an instrument within the extent of responding to the customer's request would not necessarily be categorized as "solicitation." In addition, an act of merely delivering materials used for sales to the customer passively in response to the individual requests of customers is not considered to be categorized as "solicitation" in principle. Moreover, an act of entrusting "solicitation" to another business operator and only explaining the contents of an instrument at an explanatory meeting where a large number of customers are gathered is considered not to be categorized as "solicitation" in principle. However, whether or not an act is categorized as "solicitation" should be judged substantively and carefully in light of the circumstances of each case.

#### **- Regulation on activities concerning Investment Advisory Business**

Q50. What kind of regulation is provided for with regard to Investment Advisory Business?
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- A1. The FIEA provides for regulation on activities for the case where Financial Instruments Business Operators, etc. conduct Investment Advisory Business ("special provisions concerning Investment Advisory Business").
2. Firstly, the FIEA provides for the duty of loyalty to customers and duty of due care of a prudent manager (Article 41 of the FIEA).
3. Secondly, from the viewpoint of classifying these obligations into patterns, the FIEA lists the following as acts that should be particularly prohibited with regard to Investment Advisory Business: advice intended to conduct a transaction among customers that would harm a particular customer's interest for the interest of another customer (Article 41-2(i) of the FIEA); an act of scalping (Article 41-2(ii) of the FIEA); advice intended to conduct a transaction under terms and conditions that are different from ordinary terms and conditions (Article 41-2(iii) of the FIEA); a

transaction based on the account of the business operator by using the information concerning the transaction conducted by the customer who has received advice (Article 41-2(iv) of the FIEA); and Compensation of Losses, etc. (Article 41-2(v) of the FIEA). In addition, Cabinet Office Ordinance provides for prohibited acts (Article 41-2(vi) of the FIEA; the items of Article 126 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

4. Apart from these, the FIEA provides for prohibition of sales and purchase of Securities, etc. in principle (Article 41-3 of the FIEA; Article 16-8 of the FIEA Enforcement Order), prohibition of receiving deposits of money or Securities, etc. in principle (Article 41-4 of the FIEA; Article 16-9 and Article 16-10 of the FIEA Enforcement Order), and prohibition of loans, etc. of money, etc. in principle (Article 41-5 of the FIEA; Article 16-11 of the FIEA Enforcement Order).

#### **- Regulation on activities concerning Investment Management Business**

Q51. What kind of regulation is provided for with regard to Investment Management Business?
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- A1. From the viewpoint of clarifying the fiduciary responsibility of those that conduct Investment Management Business, the FIEA provides for regulation on activities for the case where Financial Instruments Business Operators, etc. conduct Investment Management Business (“special provisions concerning Investment Management Business”).
2. Firstly, the FIEA positions (i) an investment corporation to which the assets investment of the business operator has been entrusted (Article 42(1)(i) of the FIEA), (ii) the counterparty to a Discretionary Investment Contract (Article 42(1)(i) of the FIEA), a beneficiary of a trust (Article 42(1)(ii) of the FIEA), and (iii) a person who holds interests in a self-managed collective investment scheme, etc. (Article 42(1)(iii) of the FIEA) as “Right Holders,” and provides for the duty of loyalty to Right Holders and duty of due care of a prudent manager (Article 42 of the FIEA).
3. Secondly, from the viewpoint of classifying these obligations into patterns, the FIEA lists the following as acts that should be particularly prohibited with regard to Investment Management Business: self-dealing, etc. (Article 42-2(i) of the FIEA; Article 128 of the Cabinet Office Ordinance on Financial Instruments Business, etc.); a transaction between investment properties (Article 42-2(ii) of the FIEA; Article 129 of the Cabinet Office Ordinance on Financial Instruments Business, etc.); an act of scalping (Article 42-2(iii) of the FIEA); a transaction under terms and conditions that are different from ordinary terms and conditions (Article 42-2(iv) of the FIEA); a transaction conducted based on the account of the business operator by using investment information (Article 42-2(v) of the FIEA); and Compensation of Losses, etc. (Article 41-2(vi) of the FIEA). In addition, Cabinet Office Ordinance provides for prohibited acts (Article 42-2(vii) of the FIEA; the items of Article 130(1) of the Cabinet Office Ordinance on Financial Instruments Business, etc.).
4. Thirdly, with regard to entrustment of authority of investment, the FIEA provides that the authority

can be entrusted to “another Financial Instruments Business Operator, etc. (limited to those that engage in Investment Management Business) only if required matters have been stipulated in a contract, etc. in advance (Article 42-3(1) of the FIEA; Article 16-12 of the FIEA Enforcement Order; Article 131 of the Cabinet Office Ordinance on Financial Instruments Business, etc.). However, the FIEA prohibits entrustment of the entire authority of investment with regard to all Investment Property (Article 42-3(2) of the FIEA).

5. Fourthly, the FIEA provides for the obligation of separate management of Investment Property for the case where a Financial Instruments Business Operator, etc. conducts self-management of a collective investment scheme (Article 42-4 of the FIEA; Article 132 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).
6. Fifthly, with regard to Discretionary Investment Management Business, the FIEA provides for prohibition of receiving deposits of money or Securities, etc. in principle (Article 42-5 of the FIEA; Article 16-9 and Article 16-10 of the FIEA Enforcement Order) and prohibition of loans, etc. of money or Securities in principle (Article 42-6 of the FIEA; Article 16-13 of the FIEA Enforcement Order).
7. Sixthly, the FIEA provides for the obligation to deliver investment reports (Article 42-7 of the FIEA; Article 134 and Article 135 of the Cabinet Office Ordinance on Financial Instruments Business, etc.). With regard to investment of investment trusts managed under the instructions of the settlor, the Act on Investment Trusts and Investment Corporations has its own system to obligate delivery of investment reports (Article 14(1) of said Act), so it excludes such investment from application of such obligation provided under the FIEA (Article 14(4) of said Act).

Q52. In what kind of cases is self-dealing, etc. or a transaction between investment properties possible with regard to Investment Management Business?

- A1. The FIEA explicitly prohibits self-dealing, etc. (Article 42-2(i) of the FIEA) and transactions between investment properties (Article 42-2(ii) of the FIEA) by Financial Instruments Business Operators conducting Investment Management Business, since the risk of conflict of interest is considered to be particularly high. However, acts that are categorized as such but are found to involve no problem from the viewpoint of protecting investors and securing fairness of transactions are excluded from such prohibition (the proviso to Article 42-2 of the FIEA).
2. Firstly, prohibition of self-dealing, etc. is not applied to an act of making an investment intended for brokerage of sales or purchase of Securities or Derivative Transactions pertaining to Investment Property as Type I Financial Instruments Business, Type II Financial Instruments Business, or Registered Financial Institution Business (Article 128(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.).
3. Secondly, prohibition of transactions between investment properties is not applied to an act that falls under any of the following and that makes an investment intended for conducting “sales and purchase or other transactions of target Securities, etc.” such as sales and purchase, etc. of listed

Securities conducted at a “fair price” (Article 129(1)(i), (2) and (3) of said Cabinet Office Ordinance):

- (i) the case of conducting an act for terminating investment of an Investment Property;
- (ii) the case of conducting an act for making payment of cancellation money/refunds;
- (iii) the case of conducting an act to avoid exceeding the limitations on the holding amount/ratio of assets subject to investment; or
- (iv) the case where conducting the transaction is found to be necessary and reasonable for the Investment Property of both parties in light of the investment policy, the amount of Investment Property, and the market status.

4. Thirdly, neither prohibition is applied to an act of making an investment intended for conducting either of the following transactions (Article 128(ii) and (iii) and Article 129(1)(ii) and (iii) of said Cabinet Office Ordinance):

- (i) sales or purchase of listed Securities, etc., Market Transactions of Derivatives, or Foreign Market Derivatives Transactions, or transactions conducted at a price calculated by a reasonable method in the case of having explained the contents of the transaction and the reason therefor to all Right Holders and obtained the consent of all those Right Holders for each transaction; or
- (ii) transactions for which the approval of the authorities has been obtained.

5. With regard to 4(i) above (Article 128(ii)(a) and Article 129(1)(ii)(a) of said Cabinet Office Ordinance), considering that there are cases of conducting self-dealing, etc. or transaction between investment properties for the purpose of securing the interests of all Right Holders, self-management of a collective investment scheme is excluded from the prohibition pertaining to such transaction even without the contents of all Right Holders, if certain requirements are satisfied. Such requirements include that the consent of not less than half of the Right Holders holding not less than three-quarters of all rights has been obtained and rights of Right Holders who have not given their consent have been purchased at their request.

Q53. What kind of regulation is provided for with regard to entrustment of authority of investment for Investment Management Business?

A1. The FIEA permits entrustment of authority of investment for Investment Management Business to a third party (Article 42-3(1) of the FIEA; Article 131 of the Cabinet Office Ordinance on Financial Instruments Business, etc.) only if required matters have been stipulated in (i) an entrustment agreement on asset management of an investment corporation (Article 42-3(1)(i) of the FIEA), (ii) a Discretionary Investment Contract (Article 42-3(1)(i) of the FIEA), (iii) an investment trust contract (Article 42-3(1)(ii) of the FIEA), or (iv) a contract pertaining to a self-managed collective investment scheme (Article 42-3(1)(iii) of the FIEA). However, the FIEA prohibits entrustment of the entire authority of investment with regard to all Investment Property, as representation of the self-executing obligation (Article 42-3(2) of the FIEA).

2. The authority of investment can only be entrusted to (i) another Financial Instruments Business

Operator, etc. (limited to those that conduct Investment Management Business) or (ii) a foreign juridical person that conducts Investment Management Business in a foreign state (Article 42-3(1) of the FIEA; Article 16-12 of the FIEA Enforcement Order). The entrusted operator is subject to duty of loyalty to Right Holders and duty of due care of a prudent manager (Article 42 of the FIEA) as well as the regulation of prohibited acts (Article 42-2 of the FIEA) (Article 42-3(3) of the FIEA).

3. The FIEA also provides that Financial Instruments Business Operators, etc. must not entrust authority of investment without taking measures for ensuring that the entrusted operator does not make further entrustment of the entrusted authority (excluding further entrustment of a part of the entrusted authority (limited to the case where measures have been taken to ensure that the further entrusted operator does not make further entrustment of the entrusted authority)) (Article 42-2(vii) of the FIEA; Article 130(1)(x) of the Cabinet Office Ordinance on Financial Instruments Business, etc.). This regulation is construed to prohibit further entrustment of the entirety of entrusted authority of investment and yet further entrustment of the entirety or a part of further entrusted authority of investment with regard to Investment Management Business, but allow further entrustment of a part of entrusted authority of investment (see Article 131(i) of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

#### **- Regulation on activities concerning Securities, etc. Management Business**

Q54. What kind of regulation is provided for with regard to Securities, etc. Management Business?
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- A1. As regulation on activities applied to the case where a Financial Instruments Business Operator, etc. conducts Securities, etc. Management Business, the FIEA firstly provides for duty of due care of a prudent manager toward customers (Article 43 of the FIEA).
2. Secondly, with regard to Securities-Related Business (Article 28(8) of the FIEA), the FIEA requires the business operator to separately manage the following Securities from its own property by “a method for managing property in a reliable and orderly manner” (Article 43-2(1) of the FIEA; Article 136 of the Cabinet Office Ordinance on Financial Instruments Business, etc.):
  - (i) the Securities deposited to the business operator from a customer as clearing margins (limited to those relating to Transactions of Securities-Related Derivatives (Article 28(8)(vi) of the FIEA)) or as collateral Securities for margin trading (Article 43-2(1)(i) of the FIEA); and
  - (ii) the Securities possessed by the business operator based on the account of a customer or Securities deposited to the business operator from a customer with regard to transactions pertaining to Securities-Related Business, etc. (excluding some Over-the-Counter Transactions of Derivatives/Foreign Market Derivatives Transactions, etc.) (Article 43-2(1)(ii) of the FIEA; Article 16-15 of the FIEA Enforcement Order).
3. Thirdly, the FIEA requires the business operator to separately manage the following money/Securities by the method of “trusts for the separate management of money and Securities”

(Article 43-2(2) of the FIEA; Articles 138 through 141-3 of the Cabinet Office Ordinance on Financial Instruments Business, etc.):

(i) the money deposited to the business operator from a customer as clearing margins (limited to those relating to Transactions of Securities-Related Derivatives) or as a security deposit for margin trading (Article 43-2(2)(i) of the FIEA);

(ii) the money belonging to the account of a customer or money deposited to the business operator from a customer with regard to transactions pertaining to Securities-Related Business, etc. (excluding some Over-the-Counter Transactions of Derivatives, etc.) (Article 43-2(2)(ii) of the FIEA); and

(iii) the Securities listed in (i) or (ii) of 2. above that have been furnished as security (Article 43-2(2)(iii) of the FIEA).

4. Furthermore, while assuming application of such high-level obligations of separate management and taking into account that the Investor Protection Fund system is in place to complement such obligations, the FIEA obligates Financial Instruments Business Operators to undergo external audit with regard to the state of such separate management (Article 43-2(3) of the FIEA; Article 142 of the Cabinet Office Ordinance on Financial Instruments Business, etc.). However, Registered Financial Institutions are not subject to the external audit obligation, given that they are not subject to the Investor Protection Fund system (Article 79-20(1) of the FIEA).
5. Fourthly, with regard to Derivative Transactions, etc. (excluding Transactions of Securities-Related Derivatives, etc.), the FIEA provides for the required obligation of segregated management (Article 43-3 of the FIEA; Articles 143 through 145 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).
6. Fifthly, the FIEA provides for regulation to restrict such acts as furnishing a customer's Securities as security, etc. (Article 43-4 of the FIEA; Article 146 of the Cabinet Office Ordinance on Financial Instruments Business, etc.).

## Supervision

Q55. What provisions are there regarding the issuance of an order to improve business operation to a Financial Instruments Business Operator, etc.?

- A1. From the perspective of quickly and appropriately ensuring adequate protection of investors, the FIEA does not limit the requirements for the issuance of such an order to cases of violation of laws and regulations, etc. when the Financial Instrument Business Operator's business operation or the status of its property is inappropriate. Under the FIEA, the general requirement for issuing the order is "when the Prime Minister finds it necessary and appropriate for the public interest or protection of investors, with regard to a Financial Instruments Business Operator's business operation or the status of its property" (Article 51 of the FIEA). This is basically also the same for the issuance of an order to improve business operation to a Registered Financial Institution,

although in this case, the focus is only on “business operation” while there is no provision regarding the “status of property” (Article 51-2 of the FIEA).

2. It should be kept in mind that the issuance of an order to improve business operation to a Financial Instruments Business Operator, etc. which is a registered business operator is a measure taken “within the limit necessary” and that it does not necessarily grant the FSA broad discretion.
3. In relation to the above, it is stipulated that when considering administrative dispositions against Financial Instruments Business Operators, etc., the FSA should take account of the following factors, etc. (II-5-2 of the Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.):
  - (i) seriousness and maliciousness of acts (degree of damage to public interests, extent of damage to users, maliciousness of acts, duration and repetitive nature of acts, intentionality, institutional involvement, presence or absence of cover-up actions and involvement of anti-social forces);
  - (ii) appropriateness of control environment for governance and business operation; and
  - (iii) attenuation factors.

Q56. Why does the FIEA provide for an order for the production of reports and inspection to be issued against a person who has received entrustment of business from a Financial Instruments Business Operator, etc.?

- A1. As persons who are subject to an order for the production of reports and inspection, the FIEA prescribes a Financial Instruments Business Operator, etc., a person who conducts transactions with such business operator, a Subsidiary Specified Juridical Person or a Holding Company of a Financial Instruments Business Operator, etc., as well as a person who has received entrustment of business from a Financial Instruments Business Operator, etc. (Article 56-2 of the FIEA).
2. In recent years, Financial Instruments Business Operators, etc. have come to outsource their operations more than before in order to improve the efficiency of business. However, given that various problems occur in relation to outsourcing of operations, such as system troubles and leaks of customer information, it may not be possible to take adequate measures for protecting public interests and investors by merely being able to issue an order for the production of reports and inspection against the Financial Instruments Business Operator, etc. alone. Therefore, the FIEA provides that an order for the production of reports and inspection can be issued also against a person who has received entrustment of business from a Financial Instruments Business Operator, etc.
  3. Based on the same intention, the FIEA has additionally introduced provisions on an order for the production of reports and inspection against a person who has received entrustment of business from any of the following persons: an Authorized Transaction-at-Exchange Operator (Article 60-11 of the FIEA); a Specially Permitted Business Notifying Person engaging in Specially Permitted Businesses for Qualified Institutional Investor, etc. (Article 63(7) and (8) of the FIEA); an Authorized Financial Instruments Firms Association (Article 75 of the FIEA); a Recognized

Financial Instruments Firms Association (Article 79-4 of the FIEA); an Investor Protection Fund (Article 79-77 of the FIEA); a Financial Instruments Exchange (Article 151 of the FIEA); a Foreign Financial Instruments Exchange (Article 155-9 of the FIEA); a Financial Instruments Clearing Organization (Article 156-15 of the FIEA); or a Securities Finance Company (Article 156-34 of the FIEA).

## Foreign Business Operators

Q57. How are Foreign Business Operators treated?
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- A1. When Foreign Business Operators conduct Financial Instruments Businesses as agents of residents in Japan or with them as counterparties, they are in principle required to be registered just as domestic business operators are (Article 29 of the FIEA).
2. However, in some cases, special treatment may be provided to Foreign Business Operators from the perspective of their special characteristics and the clarity of regulatory application.
3. First, Foreign Securities Brokers (Article 58 of the FIEA) do not need to be registered for Financial Instruments Business when the counterparties with which they conduct transactions are Financial Instruments Business Operators engaged in Securities-related business, for example (the proviso to Article 58-2 of the FIEA).
4. Next, Foreign Securities Brokers are subject to the permission system when they conduct Underwriting Business or Transaction-at-Exchange Operation (Articles 59 and 60 of the FIEA).
5. Foreign juridical persons and individuals domiciled in a foreign state who conduct Investment Advisory Business in a foreign state do not need to be registered as Financial Instruments Business Operators when the counterparties with which they conduct the Investment Advisory Business are limited to Financial Instruments Business Operators engaged in Investment Management Business, etc. (Article 61(1) of the FIEA). Foreign juridical persons who conduct Investment Management Business in a foreign state based on Discretionary Investment Contracts do not need to be registered, either, when the counterparties with which they do so are limited to Financial Instruments Business Operators engaged in Investment Management Business, etc. (Article 61(2) of the FIEA).
6. In addition, while collective investment scheme-type Investment Management Business (so-called self-management) is treated as Financial Instruments Business under the FIEA (Article 2(8)(xv) of the FIEA), foreign juridical persons who conduct self-management business in a foreign state do not need to be registered, either, when the counterparties with which they do so are limited to Financial Instruments Business Operators engaged in Investment Management Business, etc. as in the case of the abovementioned exceptions related to Investment Management Business based on Discretionary Investment Contracts (Article 61(3) of the FIEA).

Q58. In what kinds of cases is a Foreign Securities Broker exempted from the requirement to be registered?

A1. In the following cases, Foreign Securities Brokers are permitted to conduct Securities-related business without being registered (the proviso to Article 58-2 of the FIEA; Article 17-3 of the FIEA Enforcement Order):

- (1) the case where a Foreign Securities Broker conducts acts from a foreign state with a person in Japan who is found to have sufficient knowledge and experience, such as a Financial Institution, a trust company, or a Financial Instruments Business Operator conducting Investment Management Business, as the counterparty (Article 17-3(i) of the FIEA Enforcement Order; Articles 209 through 212 of the Financial Instruments Business Ordinance);
- (2) the case where a Foreign Securities Broker conducts acts from a foreign state, without soliciting domestic customers, (i) by receiving orders from domestic customers, or (ii) through agency or intermediary services of a Financial Instruments Business Operator conducting Securities-related business (limited to a person registered as an operator of Type I Financial Instruments Business) (Article 17-3(ii) of the FIEA Enforcement Order; Article 213 of the Financial Instruments Business Ordinance);<sup>(note)</sup> and
- (3) the case where a Foreign Securities Broker only holds discussion for fixing the contents of the Wholesale Underwriting Contract in Japan with the Issuer or holder of the Securities (excluding the case where Secondary Distribution of Securities or handling of Public Offering, Private Placement, and Secondary Distribution is conducted in Japan) (Article 17-3(iii) of the FIEA Enforcement Order; Article 214 of the Financial Instruments Business Ordinance).

(Note) In both of the cases in (i) and (ii) above, with regard to acts concerning over-the-counter transactions of Securities-related Derivatives, the domestic customers to be counterparties are limited to Financial Instruments Business Operators, etc., Qualified Institutional Investors, and stock companies, etc. with a capital amount of one billion or more (Article 17-3(ii)(a) and (b) and Article 1-8-6(1)(ii)(a) and (b) of the FIEA Enforcement Order; Article 15(1) and (2) of the Definition Ordinance).

2. When a Foreign Securities Broker conducts Underwriting Business or Transaction-at-Exchange Operation, the broker does not need to be registered, but needs to obtain permission for such act (Articles 59 and 60 of the FIEA).

Q59. In what kinds of cases is a person who conducts Investment Advisory Business or Investment Management Business in a foreign state exempted from the requirement to be registered?

A1. The FIEA does not require registration in the following cases:

- (1) the case where a foreign juridical person or an individual domiciled in a foreign state who conducts Investment Advisory Business in a foreign state engages in Investment Advisory Business with only a domestic Financial Instruments Business Operator conducting Investment Management Business or a domestic registered financial institution conducting Investment Management Business as the counterparty (Article 61(1) of the FIEA; Article 17-11(1) of the

FIEA Enforcement Order); and

(2) the case where a foreign juridical person conducting Investment Management Business based on a Discretionary Investment Contract (Article 2(8)(xii) of the FIEA) in a foreign state engages in the Investment Management Business with only a domestic Financial Instruments Business Operator Investment Management Business or a domestic Registered Financial Institution conducting Investment Management Business as the counterparty (Article 61(2) of the FIEA; Article 17-11(2) of the FIEA Enforcement Order).

2. Also, while the FIEA treats Investment Management Business in the form of a collective investment scheme (Article 2(8)(xv) of the FIEA) as a Financial Instruments Business, as in the case of Investment Management Business based on a Discretionary Investment Contract, it requires neither registration nor notification in the following case:

(3) the case where a foreign juridical person conducting Investment Management Business in the form of a collective investment scheme in a foreign state engages in the Investment Management Business with only a domestic Financial Instruments Business Operator Investment Management Business or a domestic Registered Financial Institution conducting Investment Management Business as the counterparty (Article 61(3) of the FIEA; Article 17-11(1) of the FIEA Enforcement Order).

3. Furthermore, the FIEA requires neither registration nor notification for a foreign fund operator conducting an act of Investment Management in the form of a collective investment scheme (Article 2(8)(xv) of the FIEA) who satisfies such requirements as follows: (1) the equity investors in Japan (direct equity investors/indirect equity investors) are limited to less than ten Qualified Institutional Investors or Specially Permitted Business Notifying Persons, and (2) the amount of contribution by these equity investors is not more than one-third of the foreign fund's total amount of contribution (the principal sentence of Article 2(8) of the FIEA; Article 1-8-3(1)(iv) of the FIEA Enforcement Order; Article 16(1)(xiii) of the Definition Ordinance).

Q60. How is establishment of a representative office, etc. of a foreign business operator treated under the FIEA?

A1. Under the FIEA, when a Foreign Securities Broker, a person who conducts Investment Advisory Business in a foreign state (excluding a registered business operator in Japan), or a person conducting the same type of business as the business of a trust company in a foreign state intends to establish a representative office, etc. in Japan in order to collect and provide information of the Securities market or the market of Financial Indicators pertaining to Securities, such person must give notification of the contents of the business, the location of the facility, and other matters in advance (Article 62(1) of the FIEA; Article 233(1)(iii) of the Financial Instruments Business Ordinance). Also, an order to submit a report or materials concerning the business may be issued against such persons (Article 62(2) of the FIEA).

2. Moreover, the FIEA has similar provisions for a person conducting Investment Management

Business in a foreign state (excluding a registered business operator in Japan). Since the business of forming collective investment schemes, etc. and investing funds mainly as an investment in rights pertaining to Securities or Derivative Transactions (so-called self-management) is also included in the scope of Investment Management Business (Article 2(8)(xv) of the FIEA), the FIEA also applies the abovementioned provisions on the obligation of notification and the order to submit a report or materials to a person conducting the business of self-management in a foreign state (Article 62 of the FIEA).

3. In addition, the FIEA has similar provisions for a person conducting the business of self-offering (Article 2(8)(vii) of the FIEA), the business of receiving deposits of money or Securities (excluding the business of receiving deposits of money from customers in connection to business other than Securities-related business) (Article 2(8)(xvi) of the FIEA), or the business of transfer of corporate bonds, etc. (Article 2(8)(xvii) of the FIEA) in a foreign state (Article 233(1)(i) and (ii) of the Financial Instruments Business Ordinance).
4. The matters to be included in the notification are as follows: (1) the contents of the business; (2) the location of the facility; (3) the trade name or name; (4) the location of the head office or principal office; (5) the contents of the business operations; (6) the amount of stated capital or the total amount of contribution; (7) the title and the name of the officer who has the authority of representation; (8) the name of the domestic facility, the name and address of the representative person in Japan, the reason for the establishment of the facility, the number of employees, and the planned date of establishment of the facility (Article 62(1) of the FIEA; Article 233(2) of the Financial Instruments Business Ordinance).

## Section 10 Unfair transactions, etc.

### “*Misegyoku*” (false orders to manipulate prices)

Q1. What provisions are there with regard to “*misegyoku*” (false orders to manipulate prices)?

A. Under the framework of the FIEA, so-called “*misegyoku*” (which refers to the practice of placing a market order without an intention of executing the transaction and canceling it before execution in order to steer stock market prices) is regarded as an act of market manipulation and is subject to criminal punishment and Administrative Monetary Penalty.

### Regulation on short-term sales and purchases by partnerships

Q2. What are the contents of the regulation of short-term sales and purchases by partnerships?

- A1. The FIEA provides for the following three regulations for “Specified Partnerships, etc.” whose assets include shares of a Listed Company, etc. which represent voting rights equal to or greater than 10% of the Voting Rights held by All of the Shareholders, etc. (a partnership under the Civil Code, an Investment LPS, or a Limited Liability Partnership, or a foreign organization similar to any of these partnerships (Article 27-8 of the FIEA)) (Article 165-2 of the FIEA).
2. Firstly, when a partner of a Specified Partnership, etc. makes Purchase, etc. or Sales, etc. of Specified Securities, etc. of Share Certificates, etc. pertaining to the Listed Company, etc. in relation to the assets of the Specified Partnership, etc., the partner having executed the Purchase, etc. or Sales, etc. is obligated to submit a report on the Sales and Purchase, etc. on or before the 15th day of the following month (Article 165-2(1) and (2) of the FIEA).
  3. Secondly, with regard to Specified Securities, etc. pertaining to the Listed Company, etc. that belong to the assets of the Specified Partnership, etc., if profits have accrued from making Sales and Purchase, etc. and contrary transactions of such Specified Securities, etc. within a period of six months (hereinafter referred to as “short-term sales and purchases”), that Listed Company, etc. (or its shareholder) may request provision of profits earned by such short-term sales and purchases primarily from the assets of the Specified Partnership, etc. and secondarily from the respective partners of the Specified Partnership, etc. (Article 165-2(3) through (14) of the FIEA).
  4. Thirdly, the FIEA prohibits a partner of a Specified Partnership, etc. from carrying out short selling, etc. of Specified Securities, etc. pertaining to the Listed Company, etc. with regard to assets of the Specified Partnership, etc. (Article 165-2(15) of the FIEA).
  5. These regulations have almost the same contents as the provisions of Articles 163 through 165 of the FIEA which regulate short-term sales and purchases, etc. by an Officer or Major Shareholder of a Listed Company, etc. The FIEA stipulates that the provisions of Articles 163 through 165 should not be applied to a person who will hold 10% of the Voting Rights of the Listed Company, etc. when including the Voting Rights pertaining to the shares of the Listed Company, etc. held through

the Specified Partnership, etc. (Article 165-2(16) of the FIEA), so as to avoid overlapped application of these provisions and Article 165-2 of the FIEA.